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ABSTRACT

As part of a series of hearings on the reauthorization of the Higher Education Act of 1965, testimony was heard on the safety and soundness of the Student Loan Marketing Association (Sallie Mae). Witnesses discussed many issues surrounding financial oversight of federal agencies and financial risk to the taxpayer through the potential failure of such institutions. Legislation proposed by the Administration to improve oversight was discussed as well as particulars of the financial status of Sallie Mae and recommendations for reforms to its administration. Among the witnesses testifying were the following: Michael Basham, Secretary for Federal Finance; Richard L. Fogel, Assistant Comptroller General for Government Programs, General Accounting Office; James L. Blum of the Congressional Budget Office, and Lawrence A. Hough of the Student Loan Marketing Association. Also included are the prepared statements of the witnesses and of others who could not appear for the hearing, along with letters and supplemental materials. (JB)

HEARING ON THE REAUTHORIZATION OF THE HIGHER EDUCATION ACT OF 1965: SALLIE MAE—SAFETY AND SOUNDNESS

HEARING

BEFORE THE

SUBCOMMITTEE ON POSTSECONDARY EDUCATION

OF THE

COMMITTEE ON EDUCATION AND LABOR
HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, JUNE 19, 1991

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HEARING ON THE REAUTHORIZATION OF THE HIGHER EDUCATION ACT OF 1965

WEDNESDAY, JUNE 19, 1991

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON POSTSECONDARY EDUCATION,
COMMITTEE ON EDUCATION AND LABOR,
Washington, DC.

The subcommittee met, pursuant to call, at 9:46 a.m., Room 2175, Rayburn House Office Building, Hon. William D. Ford [Chairman] presiding.

Members present: Representatives Ford, Williams, Hayes, Lowey, Sawyer, Andrews, Reed, Kildee, Murphy, Coleman, Klug, Goodling, and Gunderson.

Staff present: Thomas Wolanin, staff director; Jack Jennings, education counsel; Maureen Long, legislative associate; Gloria Gray-Watson, administrative assistant; Rose DiNapoli, minority staff director; and Jo-Marie St. Martin, minority education counsel.

Chairman FORD. The next panel will be Michael Basham, Deputy Assistant Secretary for Federal Finance, U.S. Department of the Treasury; Mr. Richard Fogel, Assistant Comptroller General for Government Programs; Mr. James L. Blum, Assistant Director for Budget Analysis, Congressional Budget Office; and Mr. Lawrence Hough, President and CEO of the Student Loan Marketing Association.

Your statements will be included in the record in full immediately following your testimony.

We will start with Mr. Basham. You can summarize, supplement, or describe your testimony in any way you think will be most helpful to this record.

STATEMENTS OF MICHAEL BASHAM, DEPUTY ASSISTANT SECRETARY FOR FEDERAL FINANCE, U.S. DEPARTMENT OF THE TREASURY; RICHARD L. FOGEL, ASSISTANT COMPTROLLER GENERAL FOR GOVERNMENT PROGRAMS, GENERAL ACCOUNTING OFFICE; JAMES L. BLUM, ASSISTANT DIRECTOR FOR BUDGET ANALYSIS, CONGRESSIONAL BUDGET OFFICE; AND LAWRENCE A. HOUGH, PRESIDENT AND CEO, STUDENT LOAN MARKETING ASSOCIATION

Mr. BASHAM. Thank you, Mr. Chairman. I have just a brief summary of my testimony that I will read.

Mr. Chairman and members of the subcommittee, it is a pleasure to be here today to discuss the results of the Treasury's study of government-sponsored enterprises and the administration's legisla-

tion that will provide for more effective financial oversight of these important institutions.

The failure of many federally-insured thrift institutions in the 1980s and the massive Federal funding required for their resolution have focused the attention of the administration and Congress on other areas of taxpayer exposure to financial risk. With this concern in mind, Congress enacted legislation requiring the Secretary of the Treasury to study and make recommendations regarding the financial safety and soundness of GSEs.

The immense size and concentration of GSE activities served to underscore the need for effective oversight of GSEs. The outstanding obligations of GSEs, including direct debt and mortgage-backed securities, totaled almost $1 trillion at the end of calendar year 1990. This is greater than the total deposits of the more than 2,000 insured savings and loans, and about one-third the size of the deposits of the more than 12,000 insured commercial banks.

Thus, financial insolvency of even one of the major GSEs would strain the U.S. and international financial systems and could result in a taxpayer-funded rescue operation.

GSEs are insulated from the private market discipline applicable to other privately-owned firms. The public policy missions of the GSEs, their ties to the Federal Government, the importance of their activities to the U.S. economy, their growing size, and the rescue of the Farm Credit System in the 1980s, have led credit market participants to view these GSEs more as governmental GSEs than as private entities.

Because of this perception, investors ignore the usual credit fundamentals of GSEs and look to the Federal Government as the ultimate guarantor of GSE obligations. Based on Standard & Poor's analysis of the financial safety and soundness of the GSEs, we have concluded, as we did last year, that no GSE poses an imminent financial threat.

Because there is no immediate problem, there may be the temptation to adhere to the old adage, "If it's not broke, don't fix it." However, this course of action would be inappropriate. The experience with the troubled thrift industry and the Farm Credit System in the 1980s vividly demonstrates that taking action once a financial disaster has already taken place is costly and difficult.

Given the need for effective financial oversight of GSEs, Treasury has developed four principles of effective safety and soundness regulation. These are: first, financial safety and soundness regulation of GSEs must be given primacy over other public policy goals. Second, the regulator must have sufficient stature to avoid capture by the GSE or special interests. Three, private market risk mechanisms can be used to help the regulator assess the financial safety and soundness of GSEs. And, four, the basic statutory authorities for safety and soundness regulation must be consistent across all GSEs.

Oversight can be tailored through regulations that recognize the unique nature of each GSE. Treasury has analyzed the adequacy of the existing regulatory structure of the GSEs against the backdrop of the four principles. One of the deficiencies we found in the existing regulatory structure is that no Federal agency has the responsi-

bility to oversee the financial safety and soundness of the Student Loan Marketing Association, or Sallie Mae.

While Treasury has some nominal authority over Sallie Mae, the authority is not parallel with that already in place or being proposed for other GSEs. The administration's proposed legislation would expand Treasury's current oversight responsibilities over Sallie Mae to make them consistent with the safety and soundness authorities of other regulators.

Under existing law, Sallie Mae is required to submit a report of its annual audit by a certified independent auditing firm to the Secretary of the Treasury and is required to provide the Secretary with access to all of Sallie Mae's books and records. The Secretary, in turn, is required to report to the President and Congress on the financial condition of Sallie Mae, including a report on any impairment of capital or lack of sufficient capital noted in the audit.

The administration proposes that Treasury's regulatory authority over Sallie Mae be expanded to include the authority to determine capital standards, to require information disclosure, to prescribe standards for books and records, and to take prompt corrective action and administrative enforcement actions, as needed.

The administration proposal also establishes a safe harbor for Sallie Mae if it receives the highest investment credit rating from two nationally recognized credit rating organizations. If the Secretary determines that Sallie Mae merits the highest investment grade rating, Sallie Mae would be deemed to meet the proposed minimum risk-based capital requirement for 1 year following the date of the Secretary's determination. This would result in a significantly reduced regulatory burden for Sallie Mae, which is appropriate for a financially strong GSE.

Sallie Mae received a triple-A rating from Standard & Poor's Corporation, a credit rating agency, when it was rated for the purpose of the April 1991 Treasury report on GSEs. Sallie Mae would, in all likelihood, be eligible for this safe harbor, assuming its financial condition had not deteriorated significantly from the time S&P conducted its analysis.

In conclusion, given the immense size of GSEs and the tremendous concentration of potential risk in so few institutions, the taxpayer is entitled to expect Congress and the administration to focus on more effective oversight of these institutions. We believe that passage of this legislation will result in more effective oversight of these important entities, sharply reducing the threat the taxpayer would be called upon for another costly and painful financial rescue.

Moreover, effective safety and soundness oversight, by assuring the long-term financial viability of GSEs, will enhance the effectiveness of these entities in achieving their public purposes. Action on this legislation will send a strong signal that we have learned some important lessons from the recent and painful difficulties we have experienced in the financial services industry.

Thank you.

[The prepared statement of Michael Basham follows:]

FOR RELEASE ON DELIVERY
Expected at 9:30 a.m.
June 19, 1991

STATEMENT OF MICHAEL E. BASHAM
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR FEDERAL FINANCE
BEFORE THE SUBCOMMITTEE ON POSTSECONDARY EDUCATION OF THE
HOUSE COMMITTEE ON EDUCATION AND LABOR

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here today to discuss the results of the Treasury's second study of Government-sponsored enterprises and the Administration's legislation that will provide for more effective financial oversight of these important institutions.

The failure of many federally insured thrift institutions in the 1980s, and the massive Federal funding required for their resolution, have focused the attention of the Administration and Congress on other areas of taxpayer exposure to financial risk. With this concern in mind, Congress enacted legislation requiring the Secretary of the Treasury to study and make recommendations regarding the financial safety and soundness of GSEs.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) requires the Treasury to conduct two annual studies to assess the financial safety and soundness of the activities of all Government-sponsored enterprises. The first of these studies was submitted to Congress in May 1990.

The Omnibus Budget Reconciliation Act of 1990 (OBRA) requires the Treasury to provide an objective assessment of the financial soundness of GSEs, the adequacy of the existing regulatory structure for GSEs, and the financial exposure of the Federal Government posed by GSEs. In addition, OBRA requires the Treasury to submit to Congress recommended legislation to ensure the financial soundness of GSEs. Legislation reflecting the approach identified in the April 30th report has been submitted.

The 1991 study is intended to meet the study requirements of FIRREA and OBRA. It includes an objective assessment of the financial soundness of the GSEs, which was performed by the Standard & Poor's Corporation (S&P) at the Treasury's request. The study also includes the results of the Treasury's analysis of the existing regulatory structure for GSEs and recommendations for changes to this structure.

The immense size and concentration of GSE activities serve to underscore the need for effective financial safety and soundness regulation of GSEs. The outstanding obligations of the GSEs, including direct debt and mortgage-backed securities, totaled almost $1 trillion at the end of calendar year 1990. Thus, financial insolvency of even one of the major GSEs would strain the U.S. and international financial systems and could result in a taxpayer-funded rescue operation.

The concentration of potential taxpayer exposure with GSEs is obvious when compared to the thrift and banking industries. The total of credit market debt plus mortgage pools of the five GSEs included in this report is greater than the total deposits of the more than 2,000 insured S&Ls and about one-third the size of the deposits of the more than 12,000 insured commercial banks. Consequently, the Federal Government's potential risk exposure from GSEs, rather than being dispersed across many thousands of institutions, is dependent on the managerial abilities of the officers of a relatively small group of entities.

Despite the size and importance of their activities, GSEs are insulated from the private market discipline applicable to other privately owned firms. The public policy missions of the GSEs, their ties to the Federal Government, the importance of their activities to the U.S. economy, their growing size, and the rescue of the Farm Credit System in the 1980s have led credit market participants to view these GSEs more as governmental than as private entities. Because of this perception, investors ignore the usual credit fundamentals of the GSEs and look to the Federal Government as the ultimate guarantor of GSE obligations. Therefore, some GSEs are in a position to increase financial leverage virtually unconstrained by the market or by effective oversight. Greater leverage results not only in higher returns for GSE shareholders, but also in potentially greater taxpayer exposure if a GSE experiences financial difficulty.

Based on the S&P analysis of the financial safety and soundness of the GSEs, we have concluded, as we did last year, that no GSE poses an imminent financial threat. Because there is no immediate problem, there may be the temptation to follow the old adage "if it's not broke, don't fix it". We, however, believe that this course of action would be inappropriate. The experience with the troubled thrift industry and the Farm Credit System in the 1980s vividly demonstrates that taking action once a financial disaster has already taken place is costly and difficult.

Given the need for effective financial oversight of the GSEs, the Treasury has developed four principles of effective safety and soundness regulation. These principles are:

I. **Financial safety and soundness regulation of GSEs must be given primacy over other public policy goals.**

Regulation of GSEs involves multiple public policy goals. Without a clear statutory preference, a current GSE regulator need not give primary consideration to safety and soundness oversight. Therefore, unless a regulator has an explicit primary statutory mission to ensure safety and soundness, the Government may be exposed to excessive risk.

II. **The regulator must have sufficient stature to avoid capture by the GSEs or special interests.**

The problem of avoiding capture appears to be particularly acute in the case of regulation of GSEs. The principal GSEs are few in number; they have highly qualified staffs; they have strong support for their programs from special interest groups; and they have significant resources with which to influence political outcomes. A weak financial regulator would find GSE political power overwhelming and even the most powerful and respected Government agencies would find regulating such entities a challenge. Clearly, it is vital that any GSE financial regulator be given the necessary support, both political and material, to function effectively.

The Treasury Department is under no illusions concerning the capture problem. No regulatory structure can ensure that it will not happen. Continued recognition of the importance of ensuring prudent management of the GSEs and vigilance in this regard by both the executive and legislative branches will be necessary.

III. Private market risk mechanisms can be used to help the regulator assess the financial safety and soundness of GSEs.

The traditional structure and elements of financial oversight are an important starting point for GSE regulation. However, Governmental financial regulation over the last decade has failed to avert financial difficulties in the banking and thrift industries. Additionally, the financial services industry has become increasingly sophisticated in the creation of new financial products, and the pace of both change and product innovation has accelerated in the last several years. As a result, to avoid the prospect that GSEs might operate beyond the abilities of a financial regulator and to protect against the inherent shortcomings in applying a traditional financial services regulatory model to entities as unique as GSEs, it would be appropriate for the regulator to enlist the aid of the private sector in assessing the creditworthiness of these firms.

IV. The basic statutory authorities for safety and soundness regulation must be consistent across all GSEs. Oversight can be tailored through regulations that recognize the unique nature of each GSE.

The basic, but essential, authorities that a GSE regulator should include:

(1) authority to determine capital standards;

(2) authority to require periodic disclosure of relevant financial information;

(3) authority to prescribe, if necessary, adequate standards for books and records and other internal controls;

(4) authority to conduct examinations; and

(5) authority to take prompt corrective action and administrative enforcement, including cease and desist powers, for a financially troubled GSE.

Consistency of financial oversight over GSEs does not imply that the regulatory burden is the same irrespective of the GSEs' relative risk to the taxpayer. Weaker GSEs should be subjected to much closer scrutiny, while financially sound GSEs should be subjected to less intensive oversight. However, the basic powers of the regulator to assure financial safety and soundness should be essentially the same for all GSEs.

Regulatory discretion is necessary within these broad powers because the GSEs are unique entities and, as such, need regulatory oversight that reflects the nature of the risks inherent in the way each conducts its business. Additionally,

because financial products and markets change rapidly, regulatory discretion would allow for flexibility to deal with the changing financial environment.

The Treasury has analyzed the adequacy of the existing regulatory structure of the GSEs against the backdrop of the four principles of effective financial safety and soundness regulation. One of the deficiencies in the existing regulatory structure for GSEs is that no Federal agency has the responsibility to oversee the financial safety and soundness of the Student Loan Marketing Association (Sallie Mae). While Treasury has some nominal authority over Sallie Mae, the authority is not parallel with that already in place or being proposed for other GSEs.

Treasury Regulatory Authority Should be Expanded

The Administration's proposed legislation would expand Treasury's current oversight responsibilities over Sallie Mae in to make them consistent with the safety and soundness authorities of the other regulators.

Under existing law, Sallie Mae is required to submit a report of its annual audit by a certified independent auditing firm to the Secretary of the Treasury and is required to provide the Secretary with access to all of Sallie Mae's books and

records. The Secretary, in turn, is required to report to the President and Congress on the financial condition of Sallie Mae, including a report on any impairment of capital or lack of sufficient capital noted in the audit. The Administration proposes that Treasury's regulatory authority over Sallie Mae be expanded to include the authority to determine capital standards, to require information disclosure, to prescribe standards for books and records, and to take prompt corrective and administrative enforcement actions.

The Administration proposal also establishes a safe harbor for any GSE that receives the highest investment grade credit rating from two nationally recognized statistical rating organizations (NRSROs). If the Secretary determines, after receiving ratings from two NRSROs, that Sallie Mae merits the highest investment grade rating, Sallie Mae would be deemed to meet the proposed minimum risk-based capital requirement for one year following the date of the Secretary's determination. This would result in a significantly reduced regulatory burden for Sallie Mae, which is appropriate for a financially strong GSE.

Sallie Mae received a triple-A rating from S&P, an NRSRO, when it was rated for the purpose of the April 1991 Treasury report on GSEs. Sallie Mae would, in all likelihood, be eligible for this safe harbor, assuming its financial condition had not

deteriorated significantly from the time S&P conducted its analysis.

Conclusion

In conclusion, given the immense size of GSEs and the tremendous concentration of potential risk in so few institutions, the taxpayer is entitled to expect Congress and the Administration to focus on more effective oversight of these institutions. The recommendations which I have outlined form the basis for the GSE legislation the Administration has proposed. We believe that the passage of this legislation will result in more effective safety and soundness oversight of these important entities, thereby sharply reducing the threat the taxpayer would be called upon for another costly and painful financial rescue. Moreover, effective safety and soundness oversight, by assuring the long-term financial viability of the GSEs, will enhance the effectiveness of these entities in achieving their public purposes. Action on this legislation will send a strong signal that we have learned some important lessons from the recent and painful difficulties we have experienced in the financial services industry.

This concludes my prepared statement. I will be happy to answer any questions that you may have.

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Chairman FORD. Mr. Fogel.

Mr. FOGEL. Thank you, Mr. Chairman.

There is a recurring issue with respect to the federally-connected but privately-owned GSEs. How can we best balance the stockholders' interest with the government's twin objectives of achieving program purposes and minimizing risk to the taxpayer?

The problems of the thrift industry brought renewed attention to the question of taxpayer risk. The FIRREA legislation required GAO to issue two reports on this matter. Last year we reported that the GSE oversight was inadequate to protect the taxpayer's interest, particularly for Fannie Mae, Freddie Mac, and Sallie Mae. On May 22 of this year, we recommended in our second report a regulatory structure and regulatory authorities including the authority to set capital rules to protect the government against the risk posed by GSEs.

To oversee the GSEs and protect the government's interest, we recommend an independent Federal enterprise regulatory board, with a presidentially-appointed chairperson, and the Secretary of the Treasury and the Chairman of the Federal Reserve as voting members. The Secretaries of Agriculture, Education, and HUD would be nonvoting members to assure that the regulator is aware of program policy considerations and has access to any program expertise that may be needed.

We also recommended that the board be given clear authority to establish safety and soundness rules for all GSEs, including risk-based capital rules, authority to monitor compliance with these rules, and authority to take appropriate enforcement actions similar to those of a bank regulator in the event of noncompliance.

Current arrangements for regulating the GSEs, including Sallie Mae, do not provide adequate protection for the taxpayer, who has already been called upon to bail out the Farm Credit System. GSEs can get into trouble and may turn to the Federal taxpayer when they do. We believe that implementing our recommendations would help protect against that risk.

Sallie Mae is somewhat unique in that it is not currently regulated. While its student loan operations have to conform to the Department of Education and the guarantor agency's requirements and its books and records may be audited by the Department of the Treasury, no government agency is responsible for overseeing the safety and soundness of Sallie Mae.

Sallie Mae, though, poses little risk to the government from its current operations. The guarantees on its student loans greatly reduce Sallie Mae's credit risk, and current management of its assets and liabilities greatly reduce Sallie Mae's interest rate risk.

However, risks and management of those risks can change. Before the Farm Credit crisis and the thrift crisis, those institutions were thought to be well-managed and posed little risk. We are now recognizing the huge cost associated with inadequate regulation of both of those types of institutions.

Sallie Mae's managers, management policies and procedures, and business risk can also change, creating additional risk for the government. We believe the time is to act now before problems emerge. We have seen too often, in working with the Congress in dealing with the savings and loan crisis, the Farm Credit crisis,

indeed, now, somewhat the problems in the banks, that it is much easier and a great deal less expensive to prevent problems than to try to solve them when you are in the midst of a financial disaster.

Accordingly, we urge Congress to establish an appropriate regulatory structure, including risk-based capital requirements as a defense against the potential that the taxpayer will be asked to solve problems affecting the GSEs, including Sallie Mae.

[The prepared statement of Richard L. Fogel follows:]

Insert 6

United States General Accounting Office

GAO Testimony

For Release
on Delivery
Expected at
9:30 a.m. EDT
Wednesday
June 19, 1991

Improved Regulatory Structure and Minimum Capital Standards are Needed for Government-Sponsored Enterprises

Statement of
Richard L. Fogel
Assistant Comptroller General
General Government Programs

Before the
Subcommittee on Postsecondary Education
Committee on Education and Labor
House of Representatives

GAO/T-GGD-91-42

GAO Form 160 (12/87)

IMPROVED REGULATORY STRUCTURE AND MINIMUM CAPITAL STANDARDS ARE NEEDED FOR GOVERNMENT-SPONSORED ENTERPRISES

Summary of Statement By
Richard L. Fogel
Assistant Comptroller General
General Government Programs

In response to a request from the Honorable William D. Ford, Chairman, House Subcommittee on Postsecondary Education, Committee on Education and Labor, GAO presented its recommendations for improving federal oversight and capital rules for government-sponsored enterprises (GSE).

GAO found that shortcomings in current federal oversight of GSEs inhibit the government's ability to identify future problems that could lead to taxpayer losses and to deal with any such problems. Current federal regulators lack sufficient authority and responsibility to enforce safety and soundness rules and require minimum capital based on the risks undertaken by the GSEs. In addition, the current regulatory structure lacks sufficient prominence in government and independence from GSEs and the markets they serve to effectively and efficiently protect the government's interest in GSEs.

GAO recommends that Congress establish an independent Federal Enterprise Regulatory Board to oversee the activities of GSEs. The Board would be headed by a Board of Directors comprised of three voting members--a presidentially appointed Chairperson, the Secretary of the Treasury, and the Chairman of the Federal Reserve System--and three nonvoting members--the Secretaries of Agriculture, Education, and Housing and Urban Development. GAO recommends that the Board be given the authority and responsibility to establish and enforce rules of safe and sound operations, and monitor compliance with these rules.

GAO also recommends that Congress direct the Board to establish minimum required capital standards based on the risks GSEs undertake. GAO's preferred standard would include the sum of capital levels determined by (1) empirically-based tests of a GSE's capital adequacy to withstand credit and interest rate risk in stressful economic environments and (2) a ratio of capital to assets that establishes a level of capital for management, operations, and business risks.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss federal oversight of government-sponsored enterprises (GSE). The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 required two GAO reports on this subject; one in 1990 and another in 1991. As you may recall, in our first report,[1] we described the GSEs' purposes and operating methods, the financial risks they bear, and how they are regulated. We concluded that the sheer size of the GSEs' financial obligations, now over $1 trillion, their public purposes, and the probability that the federal government would assist a financially troubled GSE, make it appropriate for the government to (1) supervise GSE risk-taking activities and (2) establish minimum levels of capital. We were concerned that federal oversight of GSEs--particularly for Fannie Mae, Freddie Mac, and Sallie Mae--was inadequate to identify, prevent, or contain the effects of problems like those that led to taxpayer losses in the thrift industry and Farm Credit System. We said that this year we would recommend specific improvements for federal oversight of GSEs.

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[1] See our report Government-Sponsored Enterprises: The Government's Exposure to Risks, (GAO/GGD-90-97, Aug. 15, 1990).

In my testimony today, I will discuss the major recommendations contained in our May 22, 1991 report.[2] We recommend that Congress (1) provide a GSE regulator with appropriate enforcement authorities, (2) establish a new federal regulatory structure to administer GSE oversight, and (3) establish reasonable capital rules based on the risks undertaken by the GSEs. We also plan to issue later this year a third report on the results of our audit of internal risk control procedures at Fannie Mae, Freddie Mac, and Sallie Mae.

ADDITIONAL OVERSIGHT AUTHORITIES NEEDED

Our first report on GSEs found several shortcomings in federal oversight of various GSEs.

-- The Department of Housing and Urban Development (HUD) does not have clear authority to set capital rules based on the risks undertaken by Fannie Mae and Freddie Mac. Nor does HUD have the range of specific enforcement authorities typically granted to bank regulators; moreover, HUD has not fully used the authorities it has been granted. Finally, inherent conflicts could exist between HUD's housing goals and its goals as a financial regulator.

[2]See our report Government-Sponsored Enterprises: A Framework for Limiting the Government's Exposure to Risks, (GAO/GGD-91-90, May 22, 1991).

-- Sallie Mae has no federal regulator overseeing its financial activities; it also has no minimum capital requirement.

-- The Farm Credit Administration lacks specific authority to set capital standards for Farmer Mac.

-- The statutory capital rules for the Federal Home Loan Banks require a capital-to-outstanding-debt ratio that considers neither the risks of off-balance sheet activities nor the relative riskiness of various bank assets.

To adequately protect the government's objective that GSEs carry out their public purposes safely and soundly, we recommend that the GSE regulator have authorities and responsibilities to

-- establish rules that clearly define regulatory expectations and promote the safe and sound accomplishment of GSEs' purposes. These should include, but not be limited to, rules that define minimum capital levels, prohibit unsafe activities, set minimum boundaries of a sound financial condition, and establish information reporting requirements. The rules should be established using procedures that conform to the Administrative Procedures Act, including requirements for public comment before adoption of rules.

3

-- monitor financial performance and compliance with regulations to provide an adequate understanding of the GSE's operations, condition, and the potential risk to the government. The regulator should have unimpeded, timely access to all information, systems, and personnel. While such monitoring is necessary to keep the regulator well informed, it should be done as non-intrusively as possible. Monitoring should increase when conditions warrant.

-- act in a timely manner to enforce charter restrictions, regulations, and capital requirements. Enforcement actions should result from a fair and reasonable process. Enforcement authorities should be sufficiently broad, and some enforcement actions should be mandatory when pre-specified conditions are met.

-- levy assessments to cover oversight and supervision costs.

These authorities should supplement, not obstruct, the existing corporate governance at each GSE. The regulator normally would not need to involve itself in a GSE's business affairs--that is, it would not approve operating strategies, budgets, salaries, hiring, and the like. Under current charters, such powers normally are assigned to the GSEs' boards of directors. We would not change that. Permitting corporate governance the freedom to

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manage the GSEs allows them to quickly respond to changes in the marketplace and serve their customers.

Under normal conditions, regulatory activity would usually consist of performance monitoring to ensure that corporate governance is working effectively and according to established regulations. Prompt interventions by the regulator would be warranted when corporate governance processes were not working as intended or when the GSE was experiencing financial or managerial difficulties.

SINGLE INDEPENDENT REGULATOR FAVORED

Recent regulatory experiences during the thrift and Farm Credit crises indicate that an effective GSE regulator should be structured so that it is both prominent in government and objective. These characteristics should give the regulator the visibility and the capability to act promptly and effectively if a GSE experiences severe difficulties. The regulatory body should be independent from the GSEs, their competitors, and all advocacy responsibilities. To avoid possible conflicts of interest, a GSE regulator should not also regulate the market served by the GSE. Finally, fairness demands that GSEs facing similar risks receive similar regulatory treatment.

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To achieve these goals, we propose a single regulator, which we call the Federal Enterprise Regulatory Board. The Board would have three voting members--a full-time chairperson appointed by the President, the Secretary of the Treasury, and the Chairman of the Federal Reserve System. The chairperson would serve as the Chief Executive Officer of the regulatory staff. The chairperson should serve a fixed-length term and be an individual familiar with government, who has a respected record of achievement. The Secretary of the Treasury would provide financial expertise and represent the administration's views. The Federal Reserve Chairman would provide an independent view and expertise in the workings of financial markets.

To provide advice on specific agriculture, education, and housing programs and markets, the Board would have three nonvoting members--the Secretaries of Agriculture, Education, and HUD. The Secretaries would provide their views and perspectives on public policy issues. Their nonvoting status should protect the arm's-length nature of the Board by minimizing the possibility that these members use the GSEs to address public concerns not envisioned by GSE charters.

<u>REGULATORY CAPITAL REQUIREMENTS
SHOULD BE BASED ON RISKS UNDERTAKEN</u>

Requiring that GSEs maintain a minimum amount of capital provides several public benefits. Foremost, it provides some assurance of

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a buffer adequate to absorb unforseen GSE losses and to prevent taxpayer losses. Also, a capital standard gives GSE shareholders a greater incentive to demand that management not take undue risks. Finally, a capital standard provides the government a way to influence a GSE's risk-taking without involving itself in the GSE's daily business operations.

To accomplish these objectives, GSE capital requirements should (1) be based on all risks they undertake, (2) provide an adequate buffer for possible GSE losses, (3) be clear and prospective, and (4) be equitable for competing GSEs. Because Farm Credit System banks compete directly with commercial banks, their capital requirements should continue to be patterned after bank risk-based capital rules. For the other GSEs, the new Federal Enterprise Regulatory Board should establish minimum capital standards that are based on the sum of (1) empirically-based measurements of the capital needed to withstand credit risk and interest rate risk losses in stressful economic environments, commonly known as "stress tests," and (2) an amount equal to a proportion of a GSE's obligations (leverage ratio), both on- and off-balance sheet, so that capital is held for management, operations, and business risks.

Where possible, the capital standard should be based on empirical evidence and should use the best available measurement methods. The "stress tests" are especially applicable for financial firms

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in a single line of business, like GSEs, because economic environments adverse to such firms are relatively easy to identify compared with firms in multiple lines of business like banks. The specific measurements, assumptions, and ratio levels should be left to the new Board's discretion, to provide the flexibility needed to revise rules during the evolution of markets, technologies, and GSE operations. Such flexibility is currently missing for Fannie Mae and Freddie Mac, where the capital rules have become outdated now that off-balance sheet activities are commonplace.

The proposed standard needs to be the sum of the amount needed to meet the "stress test" requirement and that needed to meet the leverage ratio requirement. It must provide sufficient capital to provide a buffer against possible losses arising from all sources of risk.

CONCLUSION

I recognise that some will argue that increased regulation of GSEs is unnecessary because none of the GSEs now pose an imminent financial threat to the government. Available evidence suggests the GSEs are now generally in sound condition. However, future changes in management strategies, economic downturns, or other adverse events could precipitate future GSE losses. The speed with which a firm can go from apparently sound to

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financially imperiled was vividly demonstrated in the thrift industry, the Farm Credit System, and Fannie Mae in the early 1980s. The time to act to improve the regulatory structure and the safety and soundness of GSEs is when the situation is calm. History has shown that regulatory improvements are more difficult to design and implement in a crisis environment, after huge losses have occurred.

That concludes my prepared statement. My colleagues and I would be pleased to answer any questions.

Chairman FORD. Mr. Blum.

Mr. BLUM. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before the subcommittee to discuss the Congressional Budget Office's recent report on controlling the risks of government-sponsored enterprises and its application to the Student Loan Marketing Association. As requested, I will submit my written statement for the record and limit my remarks to a brief summary.

My statement makes three points: First, the financial risk that Sallie Mae poses to the Federal Government is very small at present. The firm which provides financing liquidity to the student loan market has consistently earned profits since it began operations in the early 1970s. Neither recessions nor sharp swings in interest rates have significantly affected this ability of Sallie Mae's earnings.

The steady profitability is both evidence of the absence of risk and a buffer against loss by taxpayers and the government as a result of Sallie Mae's operations. Sallie Mae's exposure to credit risk is small because of the nature of its assets, most of which are either guaranteed by the government or fully collateralized.

Interest rate risk is also minimized due to Sallie Mae's policy of matching the interest sensitivity of its assets and liabilities. Finally, Sallie Mae maintains a level of capital that seems ample, given its portfolio and hedging strategies.

Second, although the risks associated with Sallie Mae are currently small, there can be no iron-clad guarantees that the GSE will never fail and expose the government to loss. The Association could elect or be forced to adopt a business strategy in the future that would expose the government to greater risk.

In any event, it is highly likely that the Federal Government would assume responsibility for losses incurred by Sallie Mae on its $40 billion portfolio in excess of its equity capital, which now exceeds $1 billion. Thus, the government has a substantial interest in the extent to which Sallie Mae assumes risk in the future.

Third, there are several defensive strategies available to the Federal Government for reducing the possibility of future loss. These include privatizing Sallie Mae and thus severing the ties between the GSE and the Federal Government, establishing an improved early warning system to detect increases in risk-taking, and creating a Federal regulator to supervise the safety and soundness of Sallie Mae.

The strategy of fully privatizing Sallie Mae could be appealing if a genuine separation, one that increases competition in the education finance system and assures continued access by education to the capital markets, could be achieved. The CBO report, however, points out several difficulties in pursuing this strategy.

The foremost difficulty is achieving a credible termination of the government's implicit guarantee. To do this, it may be necessary to transform the Association into several independent component parts. It is not clear, however, that the gains of privatization would offset the substantial legal and administrative costs involved.

A second strategy would be to require the Treasury, under existing authority, to take a greater role in monitoring Sallie Mae's risk than it has assumed to date. Sallie Mae also could be required to

make itself more susceptible to private risk assessment, for instance, by issuing subordinated debt that subjected investors to some risk of loss.

No amount of monitoring, however, can assure that the government will detect in the riskiness of Sallie Mae. It could also be argued that Sallie Mae's common stock already contains nearly as much information as could be obtained from the pricing of subordinated debt.

A third strategy is to establish a Federal regulator to supervise the safety and soundness of Sallie Mae. The administration has proposed legislation that would give Treasury a much more powerful role as a safety and soundness supervisor of Sallie Mae. The General Accounting Office has proposed creating a new agency to supervise the safety and soundness of all GSEs, including Sallie Mae.

Effective supervision requires a detailed knowledge of the regulated entity's operations. A poorly informed supervisory agency could impose more costs than benefits. The potential cost of strengthened Federal regulation could be reduced in one of two ways: first, the Congress could direct the supervisory agency to streamline monitoring and supervision of Sallie Mae as long as the Association posed little risk to the government.

Alternatively, Sallie Mae could reach a safe harbor from regulatory interference by obtaining a triple-A rating from two private rating firms, provided the supervisory agency agreed with the rating.

Under the administration's proposed legislation, the cost of enhanced monitoring and supervision of Sallie Mae would appear to be minimal, as long as Sallie Mae complied with the risk-based capital standards set by the Secretary of the Treasury. If Sallie Mae fell out of compliance, however, a succession of increasingly tough enforcement measures would be adopted.

While there seems to be little urgency in the case of Sallie Mae to adopt any of these strategies, it might be prudent to put into statute some nonintrusive measures that would guard against high risk assumption by Sallie Mae or enable the government to anticipate and address a rapid deterioration in Sallie Mae's financial condition.

Mr. Chairman, that concludes my summary.

[The prepared statement of James L. Blum follows:]

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CBO TESTIMONY

Statement of
James L. Blum
Assistant Director
Budget Analysis Division
Congressional Budget Office

before the
Subcommittee on Postsecondary Education
Committee on Education and Labor
U.S. House of Representatives

June 19, 1991

NOTICE

This statement is not available for public release until it is delivered at 9:30 a.m. (EDT), Wednesday, June 19, 1991.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Mr. Chairman, I appreciate the opportunity to appear before this Subcommittee to discuss the Student Loan Marketing Association (Sallie Mae). My testimony will be based on the Congressional Budget Office's (CBO's) recent report, *Controlling the Risks of Government-Sponsored Enterprises*. I will make three points in my statement:

- First, Sallie Mae poses a risk of loss to the government that is quite small, probably negligible.

- Second, the association could elect, or be forced, to adopt a business strategy in the future that would expose the government to greater risk.

- Third, the government has a number of options available that might reduce this exposure to risk.

THE GOVERNMENT'S CURRENT EXPOSURE TO RISK

The Student Loan Marketing Association is one of five government-sponsored enterprises (GSEs), which are privately owned, federally chartered financial intermediaries. Sallie Mae has achieved its public purposes of providing

financing and liquidity to the student loan market by issuing debt in the capital markets and providing funds to lenders who deal directly with students. The risk to the government and taxpayers arises--as with all GSEs--from the implicit federal guarantee of Sallie Mae's debt securities and the possibility that the enterprise might not be able to meet all of its debt obligations without federal assistance.

In the case of Sallie Mae, the consensus--shared by CBO--is that the risk to the government is minimal. The government's risk is quite low because Sallie Mae's exposure to risk is minimal. This conclusion emerges from a consideration of the various types of risk to which this sponsored enterprise is subject--namely, credit, interest rate, program, and management and operating risks.

Credit Risk

Credit risk arises because a lender cannot be sure that a borrower will be able and willing to repay a loan. Sallie Mae engages in two basic types of lending: warehousing advances and loan purchases. Through the Warehousing Advance Program, Sallie Mae lends money to financial and educational

institutions and to state agencies to enable the borrower to make or hold student and other education-related loans. Warehousing loans are fully secured by borrowers' pledges of federally insured assets, such as Guaranteed Student Loans (GSLs), Treasury, or agency debt. Under the Loan Purchase Program, Sallie Mae buys student loans from originators. Many lenders prefer to originate and hold loans when the student is in school and the loan is inexpensive to service (because no payments have to be collected from students) and to sell loans just before the student leaves school, after which servicing becomes more complex and expensive.

In addition to purchasing loans and making warehousing advances, Sallie Mae has the authority (provided by the 1986 amendments to the Higher Education Act) to buy, sell, insure, or underwrite obligations made to finance plant and equipment for institutions of higher education. Sallie Mae currently offers secured financing to educational institutions for academic facilities. Sallie Mae also holds 75 percent of the outstanding voting common stock of the College Construction Loan Insurance Association (Connie Lee), a mixed-ownership, for-profit corporation chartered by the Congress in 1986 to insure and reinsure obligations for educational facilities.

Sallie Mae's exposure to credit risk is small because most of its assets are either guaranteed by the federal government or fully collateralized by federally guaranteed claims. Unless a GSL has not been properly serviced, Sallie Mae has a direct claim for 100 percent of principal to the guarantee agencies and an indirect claim to the federal government. However, Sallie Mae could experience losses as a result of the insolvency of a guarantee agency, default on an insufficiently collateralized warehousing advance, or the bankruptcy of a firm with which Sallie Mae has financial agreements.

<u>Guarantee Agency Risk</u>. Agencies that guarantee GSLs receive 100 percent reinsurance from the federal government so long as their annual default rates are less than 5 percent of their total guarantees. Agencies with default rates greater than 5 percent must pay from their own resources the difference between the insured amount due to the holder of the defaulted GSL and the amount recovered from the federal government (at least 10 percent of the amount due). These costs may eventually deplete the reserves of the guarantee agency and force the agency into default on its guarantee commitments.

One example of this risk involved the Higher Education Assistance Foundation (HEAF) case. In that instance, although the U.S. government had

no legal obligation to do so, all GSL holders were fully protected from loss. If that case indicates current federal policy toward the liabilities of the guarantee agencies, then Sallie Mae's credit risk exposure from this quarter is very small.

Risk from Warehousing Loans. Warehousing advances are also subject to default losses, if the loans are not sufficiently collateralized. Sallie Mae is aware of this risk and has policies in place to require 100 percent (or more) of high-quality collateral to secure these advances. To date, Sallie Mae has not incurred any losses from defaults on warehousing advances.

Interest Rate Risk

Interest rate risk occurs when the margin between interest income and interest expense is affected by changes in the level of interest rates. Interest income on most of Sallie Mae's assets tends to move with the open-market interest rates on Treasury securities to which they are indexed. For example, the rate of interest received by Sallie Mae on a Stafford loan is 3.25 percent above the average 91-day Treasury bill rate, adjusted every three months for changes in the bill rate.

If, however, Sallie Mae were to finance its variable-rate loans with fixed-rate debt, a fall in interest rates would reduce interest income but leave interest expense unchanged. In that case, Sallie Mae would suffer losses. To avoid this risk, Sallie Mae has matched the interest sensitivity of its debt with the interest sensitivity of its assets.

On occasion, however, Sallie Mae believes that it can minimize its long-term interest costs (and maximize its net interest income) by issuing fixed-rate debt. To avoid the risk inherent in this mismatch between assets and liabilities, Sallie Mae uses interest rate exchange contracts or "swaps." Under these agreements, Sallie Mae pays a variable interest rate stream in exchange for a flow of payments sufficient to meet its fixed-rate obligations. With such a hedge in place, Sallie Mae's interest expense varies with its interest income, and a positive income spread is assured.

To hedge against the adverse effects on income of changes in interest rates, Sallie Mae enters into interest rate exchange agreements under which it pays a floating interest rate in exchange for fixed interest rate payments. If the party with which Sallie Mae exchanges interest payments defaults on its promise, Sallie Mae is subject to losses equal to the cost of replacing the agreement. Sallie Mae has employed various means of minimizing this risk,

such as carefully screening and monitoring the credit quality of those with whom it enters such agreements. Sallie Mae has suffered only one loss of modest size ($300,000) on such a default.

Program Risk

Some observers believe that the greatest threat to Sallie Mae's financial viability comes from the government itself. Sallie Mae is currently attuned to and depends on existing federal policy toward postsecondary education. That policy, of course, could be changed. If, for example, the GSL program were to be dropped in favor of a direct federal loan program for students, the change could adversely affect the financial outlook for Sallie Mae.

The existing stock of GSL contracts, however, assures Sallie Mae of opportunities to generate earnings for the next 7 to 10 years, even if the GSL program were to be terminated. During this transition, Sallie Mae would shrink in absolute size, but the firm's investors would not be exposed to loss from the downsizing of the firm. In fact, it is reasonable to expect that with a built-in transition period, Sallie Mae would be able to adapt its specialized financial knowledge and low-cost loan servicing operations so that it could

continue to play a role in postsecondary education finance. For example, if the government establishes a federal direct loan program, Sallie Mae might be a successful bidder for loan servicing. If the federal direct loan program is targeted at low-income students, Sallie Mae might be able to develop a direct loan program for moderate- and higher-income students.

Management and Operations Risks

Federal guarantees of student loans are not unconditional. To collect from a guarantor agency and ultimately from the federal government, the holder of a GSL must be able to demonstrate that it has complied with a variety of "due diligence" requirements. If Sallie Mae were to fail to service its loan portfolio according to federal regulations, it could suffer significant losses even though it holds federally guaranteed assets. CBO did not examine Sallie Mae's operating and internal control systems because this is outside our area of expert knowledge. We therefore cannot offer any definitive conclusions about the association's exposure to management and operations risks.

We did ascertain, however, that this source of risk has not been a significant factor in Sallie Mae's past earnings. We did so by confirming that

Sallie Mae's earnings have shown extraordinary stability. Since Sallie Mae began operating, it has consistently earned profits. Sallie Mae's earnings have been relatively unaffected by recession, sharp swings in interest rates, declines in real estate and commodity prices, and changes in management and operating systems. The stability of earnings per dollar of assets means that the principal determinant of Sallie Mae's earnings has been the book value of assets held by the firm.

SALLIE MAE AND FUTURE RISK

Although the past is prologue, there is no guarantee that Sallie Mae will always be able to avoid and control risks as completely as it has in the past. One could more confidently predict the future if one could explain the past, but it is not clear why Sallie Mae has operated as it has. A change in environment--in federal policy toward financing higher education, for example--could trigger a change in the composition of Sallie Mae's loan portfolio toward riskier assets. A shift in investor preferences might incline Sallie Mae toward retaining a greater portion of the interest rate risk that it now hedges. A change in management might lead to a deterioration of

internal controls and operating systems and a significant rise in the chances of operating failures. Sallie Mae's future level of risk is simply unpredictable.

It is fairly clear, however, that the federal government would assume responsibility for losses incurred by Sallie Mae on its portfolio in excess of its equity capital, which now exceeds $1 billion. Thus, the government has a substantial interest in the extent to which Sallie Mae assumes risk in the future.

OPTIONS FOR LIMITING FUTURE FEDERAL EXPOSURE TO RISK

The implicit federal guarantee of Sallie Mae's liabilities raises the policy issue, therefore, of what action--if any--the federal government should take now to address the possibility that Sallie Mae might adopt a significantly more risky financial posture in the future. CBO's report discusses three federal strategies.

- o The first is to fully privatize Sallie Mae and thus terminate all federal responsibility for the enterprise's debt.

- The second is to put in place an enhanced "early warning" system for detecting increases in risks that the association assumes.

- The third is to give a federal agency statutory authority to limit Sallie Mae's ability to choose more risky lines of business and modes of operation and to set and enforce capital standards for the GSE.

The first strategy is appealing if a genuine separation--one that increases competition in the education finance system and assures continued access by education to the capital markets--can be achieved. If, however, the government wishes to maintain a close relationship with the dominant firm in this market, then adding an early warning or supervisory mechanism to an otherwise unchanged Sallie Mae could be prudent. If the latter option is chosen, consideration could be given to establishing a streamlined supervisory process, or permitting Sallie Mae to reach a "safe harbor" from federal regulation, provided that the enterprise continues to adhere to the highest commercial standards of safety and soundness. The "safe harbor" provision is intended to afford some protection from an overzealous regulator that

might do substantial, but needless, harm to the public policy objectives of Sallie Mae.

Privatize Sallie Mae

One of the major difficulties to be overcome by attempts at privatization is that the severing of all federal responsibilities for the GSE's debt must be credible. This requirement is made all the more difficult because the current federal guarantee of Sallie Mae's debt is not explicit. One approach to a credible renunciation of the implicit guarantee is to make it explicit. Under this approach, the federal government would explicitly guarantee the timely payment of interest and principal for all outstanding securities issued by Sallie Mae before the effective date. This guarantee should be extended by statute. When the guarantee is made explicit, a schedule should also be announced for its withdrawal. One option would be to guarantee existing issues to their maturity or for some fixed period (say three years), whichever is less.

One of this plan's shortcomings is that it would leave the Student Loan Marketing Association as the issuer of more than $40 billion in outstanding debt. Given the power of the notion of "too big to fail," the markets might

continue to perceive Sallie Mae debt as implicitly guaranteed by the federal government, despite the expiration of the explicit guarantee.

This shortcoming suggests that the effective privatization of Sallie Mae would require dividing the firm into several independent entities. Specifically, Sallie Mae could be required to divest itself gradually of its component operations, assets, and liabilities by distributing to its current common and preferred investors shares in each of several, new, fully private, independent firms created from Sallie Mae. The new entities would have none of the links to the federal government that normally distinguish GSEs, such as a line of credit at the Treasury or exemption from the Securities and Exchange Commission's registration requirements or state laws that protect investors. They would also be subject to the antitrust laws.

By creating several new and correspondingly smaller entities, markets might be persuaded that the federal government would not intervene to protect creditors from loss in the event of insolvency by one of these firms. This result requires that none of the surviving entities be too big to fail. In addition, this approach could significantly increase competition in the secondary market for GSLs and assure the continued access of primary lenders to the capital markets.

Increase Treasury Department Oversight and Early Warning

A second option discussed in CBO's report would be that of requiring the Department of the Treasury, under existing authority, to examine Sallie Mae's five-year strategic and annual budget and business plans. This might enable Treasury to anticipate changes in planned risk at Sallie Mae and to alert the President and the Congress in time to block them, if desired.

This approach requires the Treasury to take a greater role in monitoring Sallie Mae's risk. No amount of monitoring can assure that the government will detect an increase in the riskiness of Sallie Mae. For example, changes in the structure of the GSL program may force Sallie Mae into unplanned departures from its long-term business plan. Also, management may take steps to increase risks that were not contemplated in advance, although it has substantial incentives not to do so. Thus, the Treasury may not detect an increase in risk until it has occurred. When a significant increase in risk is detected, the Secretary could recommend removal of the board.

A shortcoming of this approach is that the Treasury Secretary and the President might be reluctant to remove the board, especially if increased risk

had not led to losses. Some observers have suggested that a supervisory agency with a statutory mandate to assure safe and sound operation and equipped with sufficient enforcement powers would be less reluctant to act.

Increased use of private risk assessment might also enhance federal oversight and early warning effectiveness. For example, Treasury might be required to report publicly the market value of the association's assets, liabilities, and contingencies. Private credit rating agencies could also be used to rate the government's exposure to risk. Finally, if an agency was adequately capitalized, it could be required to issue subordinated debt that did not carry a federal guarantee.

Assign a New Supervisor for Sallie Mae

A third approach would be to create a new agency with responsibility for supervising the safe and sound operation of all GSEs, including Sallie Mae, as the General Accounting Office has proposed. The agency would have statutory authority to examine Sallie Mae, impose a risk-based capital requirement on the GSE, enforce that capital standard and other limits on risk

taking, take action if Sallie Mae became insolvent or close to insolvency, and assess the association for the cost of supervisory activities.

Effective supervision requires a detailed knowledge of the regulated entity's operations. A regulator would have to become knowledgeable about Sallie Mae's affairs. Achieving this expertise could be costly for both Sallie Mae and the supervisory agency. A poorly informed supervisory agency, however, might set a capital requirement that did not take into account Sallie Mae's true exposure to risk and thereby impose unnecessary costs on Sallie Mae's shareholders, as well as lenders, students, and postsecondary education institutions. Because Sallie Mae currently poses so little risk to the government and has strong incentives to continue operating in a low-risk manner, there are no guarantees that the potential benefits from effective supervision--prevention of greater risk taking by the GSE--are worth the potential costs associated with poorly informed supervision.

The high information needs and costs essential to effective, controlling regulation could be reduced in one of two ways. First, the Congress could direct the supervisory agency to streamline monitoring and supervision of Sallie Mae as long as the GSE posed little risk to the government. A streamlined regulatory process would minimize the explicit and implicit cost

of more intensive monitoring of Sallie Mae. Alternatively, Sallie Mae could reach a "safe harbor" from regulatory interference by obtaining a triple-A rating from two private rating agencies, provided the supervisory agency agreed with the rating. (Such agreement appears to be necessary to avoid an unconstitutional delegation of federal authority to a nongovernmental entity.) The GSE probably could obtain such a rating at very little cost to stockholders. If Sallie Mae achieved and maintained the rating, the supervisory agency would be able to monitor Sallie Mae, but could not require any changes in its operations. However, if the enterprise fell out of compliance with the standard, it could be required to submit a business plan to the supervisory agency that would enable it to comply within one year. If Sallie Mae failed to comply within that period, the agency would be able to impose a business plan on it.

The Administration has proposed legislation that would give the Treasury a much more powerful role as the supervisor of the safety and soundness of Sallie Mae. The bill would establish a statutory leverage limit and a critical capital ratio for Sallie Mae and greatly increase the Secretary's statutory authority with respect to issues of safety and soundness. The Secretary would be required to define a minimum risk-based capital standard for the enterprise that exceeded the statutory leverage limit. The risk-based

standard would include components for credit, interest rate, business, and management and operations risks. If Sallie Mae failed to comply with the risk-based standard the Secretary sets, the Secretary could disapprove any of the GSE's activities and would possess a spectrum of mandatory and discretionary enforcement powers. The enforcement powers would be identical to those the Administration's banking reform legislation proposes be given to the Federal Deposit Insurance Corporation (FDIC), and would become increasingly tough as Sallie Mae's capital fell short of the minimum risk-based standard imposed by the Secretary.

CONCLUSION

The financial risk that Sallie Mae poses to the federal government is very small at present. The firm, which provides financing and liquidity to the student loan market, has consistently earned profits since it began operations in the early 1970s. Neither recessions nor sharp swings in interest rates have significantly affected the stability of Sallie Mae's earnings. This steady profitability is both evidence of the absence of risk and a buffer against loss by taxpayers and the government as a result of Sallie Mae's operations.

Sallie Mae's exposure to credit risk is small because of the nature of its assets, most of which are either guaranteed by the government or fully collateralized. Interest rate risk is also minimized, because of Sallie Mae's policy of matching the interest sensitivity of its assets and liabilities. Finally, Sallie Mae maintains a level of capital that seems ample, given its portfolio and hedging strategies.

Although the risks associated with Sallie Mae are currently small, there can be no ironclad guarantees that the GSE will never fail and expose the government to loss. Several defensive strategies are available to the federal government for reducing the possibility of future loss. These include privatizing Sallie Mae and thus severing the ties between the GSE and the federal government, establishing an improved "early warning" system to detect increases in risk taking, and creating a new federal regulator to supervise the safety and soundness of Sallie Mae.

While there seems to be little urgency by Sallie Mae to adopt any of these strategies, it might be prudent to put into statute some nonintrusive measures that would guard against higher risk assumption by Sallie Mae or would enable the government to anticipate and address a rapid deterioration in Sallie Mae's financial condition.

Chairman FORD. Mr. Hough.

Mr. HOUGH. Mr. Chairman and members of the subcommittee, I am Lawrence Hough, president and chief executive officer of Sallie Mae. I am especially pleased to appear before this committee, because it was this committee that created Sallie Mae's charter in 1972.

Let me say clearly, at the outset, the official reports concerning GSE safety and soundness from Treasury, GAO, and CBO have all determined that Sallie Mae itself poses no risk to the taxpayer. The CBO concluded in its report Sallie Mae, without a safety and soundness regulator, has conducted its business in such a way as to have limited Federal exposure to an insignificant level.

OMB, in the 1992 budget, acknowledged that Sallie Mae is extremely strong financially. Perhaps the most noteworthy evidence of this achievement is Treasury's report that Sallie Mae holds a triple-A investment grade rating, the highest level awarded by Standard & Poor's. These studies only confirm what you and we have known all along, and that is, Sallie Mae is accomplishing the mission set forth by statute and doing so prudently.

Over the past 18 years, Congress has amended our charter numerous times to strengthen our self-sufficiency as a private corporation and to respond to the developing needs for educational credit. We have funded over 20 million loans, providing students with over $51 billion. Our programs have supported directly over 2,000 commercial banks, thrifts, schools, and State agencies.

Using authority granted during the last reauthorization, Sallie Mae has begun to finance directly higher education facilities. We have provided support to 121 institutions in 34 States for a total of more than $1.6 billion to construct facilities, acquire new equipment, and refurbish facilities in need of repair.

In the testimony preceding mine, it has been suggested that Sallie Mae needs to be regulated simply because we are not now regulated. I take strong exception to this view. Current law now provides for meaningful and effective congressional oversight, as well as ample outside scrutiny by the Department of Treasury.

Our statute specifically provides that the Secretary of Treasury keep the President and Congress informed of such operations and financial condition of the Association, including a report of any impairment of capital or lack of sufficient capital. Sallie Mae is required to submit a report of our annual audit to the Secretary of Treasury, who also enjoys full access to our books and records.

Mr. Chairman, our charter makes us subject to oversight from the education committees of Congress. With both committees, Sallie Mae has established a frequency and quality of dialogue that goes far beyond the formal reports required by statute. It also needs to be understood that, as distinguished from all other GSEs, Sallie Mae supports an activity that is itself created and regulated by the government.

Accordingly, we are reviewed by the Department of Education's Office of Inspector General, its Division of Audit and Program Review. We are reviewed by State agencies, as well as the Department of Health and Human Services. These are the extensive official oversight provisions under current law. They do not include ongoing, ad hoc reviews by GAO, CBO, OMB, Treasury and others.

There is only one Sallie Mae, and we live in a huge fish bowl. Moreoever, as a publicly-traded corporation, we are subject to the rules of the New York Stock Exchange, the antifraud provisions of the Federal securities laws, and the watchful eye of our investors and analysts on Wall Street, as well as other credit rating agencies.

Our 21-member board has a fiduciary responsibility to ensure the safety and soundness of our operations. Seven members of our board are appointed by the President of the United States, and the President also designates the chairman of the board.

However, despite our consistent success, there are those who are setting aside the conclusions from the studies that we represent no taxpayer risk and are calling for drastic regulatory proposals. While I appreciate the very positive comments I have heard this morning about our corporation's management, I would like to be very clear on the substance of what has actually been proposed by Treasury and the GAO.

What are the obvious flaws in the Treasury proposal? First, Treasury acknowledges no need for balance between financial regulation and program mission. Despite the CBO testimony that there needs to be an appropriate balance between financial regulation and programmatic mission, Treasury holds the view that financial regulation must be an absolute priority. This view is held in disregard of any consideration for concerns about student loan access, stability, and certainty for other GSL participants.

The capital levels would be set completely at the discretion of the Secretary of the Treasury. This is even when Sallie Mae is at the highest level of capital. The Secretary can prevent us from entering into transactions he believes might place us in a lower capital level. Treasury is given the clear-cut ability to control our business. In essence, the Secretary of the Treasury can veto a business transaction by unilaterally determining that Sallie Mae is engaging in an unsafe and unsound practice.

To put this power in context, under that authority, Sallie Mae could be prohibited from purchasing loans guaranteed by weaker guarantee agencies. This could create severe access problems in certain States.

What is wrong with the GAO proposal? The GAO proposal, as described in their report and highlighted today, would put in place a single super-regulator. Once we are thrown together with all GSEs and placed under an entity chartered to regulate, investors in our debt security would shift their current focus away from our creditworthiness and rely fully on the Federal Government.

At the same time, the cost of equity capital would increase, making it more expensive and difficult for Sallie Mae to raise the kind of private sector buffer to taxpayer risk which the GAO and others propose to reinforce.

Our inclusion in a group of very dissimilar and less well-positioned GSEs will also force Sallie Mae to manage to the standards of the weakest GSE, for the weakest GSE will set the risk levels a super-regulator will expect us to meet in the conduct of our business.

Mr. Chairman, the proposals put forth by both GAO and Treasury would create a discretionary and unlimited intervention mechanism, one outside your committee's control. The presence of an

entity so empowered could irrevocably alter and destabilize the structure you have crafted. It could provide a direct, unpredictable means for intervention, intervention which might be triggered as a result of dissatisfaction with the program policy objectives you would have us support.

We are not alone in voicing the risk and cost of heightening regulation, nor are we alone in believing that Sallie Mae's unique financial strength affords you, the Congress, other means of dealing with us. For example, the CBO has pointed out Sallie Mae exposes the government to a negligible amount of risk at present. The principal policy issue with respect to Sallie Mae is what action, if any, the government should take to prevent the enterprise from increasing its exposure in the future?

Mr. Chairman, I believe that this committee, with its experience overseeing programs supporting American higher education is uniquely qualified to judge how best to assure that Sallie Mae continues to perform its mission in a manner which maintains financially strong operations with no risk to the American taxpayer.

I urge you to set aside solutions which would impede Sallie Mae's ability to act quickly and creatively in response to programmatic initiatives requested or supported by our congressional overseers. I urge you to reject the proposed structures lest they be enacted and transform Sallie Mae into a corporation that manages its business for the safety and soundness regulators.

As this committee now looks ahead to the postsecondary education challenges of this decade and the next, you will need a proven source of innovation and change. I am well aware of the developing programmatic needs: programs for the middle class, a simpler Stafford program, support for nontraditional students, fail-safe contingencies for major parts of the present delivery system, to name just a few.

We are confident that, after thoughtful consultation with this committee, Sallie Mae will be able to provide critical support for these emerging needs. I am very eager to join with you and this committee to fashion a solution which we both can feel confident will ensure our continuing support of higher education. It should be a solution that draws from our strength and not one which falls prey to unfounded speculation about the future.

I look forward to working with you and would be pleased to answer any questions that you may have.

[The prepared statement of Lawrence A. Hough follows:]

TESTIMONY OF

LAWRENCE A. HOUGH

PRESIDENT AND CHIEF EXECUTIVE OFFICER

STUDENT LOAN MARKETING ASSOCIATION

BEFORE THE

HOUSE SUBCOMMITTEE ON POSTSECONDARY EDUCATION

HEARING ON GOVERNMENT-SPONSORED ENTERPRISES

June 19, 1991

Mr. Chairman and members of the Subcommittee, I am Lawrence Hough, President and Chief Executive Officer of the Student Loan Marketing Association, better known as Sallie Mae. I appreciate the opportunity to discuss the safety and soundness of Sallie Mae. I am particularly pleased that this hearing on Sallie Mae is before the committee which created our corporate charter in 1972 to assure the availability nationwide of education credit. This Committee deserves much of the credit for the successful growth of the guaranteed student loan program and the important contribution Sallie Mae has made in providing private capital to meet that growth. As the only government sponsored enterprise chartered to serve postsecondary education, Sallie Mae is proud of its record and is especially gratified that as you undertake a review of our safety and soundness, you will find that the official reports concerning GSE safety and soundness from Treasury, GAO, and CBO have all determined that Sallie Mae itself poses virtually no risk to the taxpayer.

THE RESULTS OF THE STUDIES

The Treasury, GAO, and CBO reports, and OMB in its commentary in the Budget for Fiscal Year 1992, all acknowledge Sallie Mae's successful performance in fulfilling our mission with private capital and at zero risk to the taxpayers. Perhaps the most noteworthy evidence of this achievement is Treasury's report that Sallie Mae holds a AAA investment grade rating, the highest level awarded by Standard & Poor's. At

Treasury's specific request and as a key part of the Treasury study, S&P evaluated the likelihood that each GSE might not be able to meet its future obligations from its own resources. On the basis of this study, only Sallie Mae and the Federal Home Loan Bank System achieved a AAA. To our knowledge only two commercial banks of the more than 10,000 in this country today carries such a high rating by Standard & Poor's. This is an appropriate starting point for examining the reports' commentary on how Sallie Mae has operated.

The CBO concluded in its report that Sallie Mae represents a negligible risk to the government. "...Sallie Mae...without a safety and soundness regulator has conducted its business in such a way as to have limited the federal exposure to an insignificant level." OMB, in the Budget for Fiscal Year 1992, acknowledged that Sallie Mae is "extremely strong financially" and that "so long as it manages its interest rate risk well, Sallie's only real risk is that the government might change the rules of the game." From the Treasury Report, the Standard & Poor's comments are also very positive.

> The assessment of Sallie Mae reflects its consistently good operating performance, the high quality of its asset base, and its strong risk-adjusted capitalization. Sallie Mae has managed well the servicing risks attendant upon guaranteed student loans...(Sallie Mae's) capital is maintained at levels to protect against a variety of risks, including the remote risk of guarantor failure. Leverage has increased in recent years, reflecting an active stock buyback program, but Sallie Mae remains appropriately capitalized on a risk-adjusted basis. [APRIL 1991 TREASURY REPORT, p. A-46]

THE COMPANY AND THE PUBLIC BENEFIT

These studies only confirm what you and we have known all along, Mr. Chairman, and that is that Sallie Mae is accomplishing the mission set for it by statute and is doing so prudently.

Over the past 18 years Congress has amended our charter numerous times to strengthen our self-sufficiency as a private corporation and to confirm and respond to the developing needs for education credit. Following each such change, Sallie Mae adjusted its course in an appropriate way and continued to fulfill its public mission while at the same time avoiding harmful, unnecessarily risky initiatives. The public benefits have been tremendous in terms of students served, educations obtained, and national objectives achieved. Sallie Mae has to date funded over 20 million loans, providing students with over $51 billion dollars. Today the corporation, both by buying student loans and by providing collateralized warehousing loans to participating lenders, funds about four in ten of all student loans outstanding.

By buying education loans, Sallie Mae provides lenders with the cash needed to make more student loans or other investments. Over 2,000 commercial banks, thrifts, schools, and state agencies look to Sallie Mae for a comprehensive array of financial services --

loan purchases, financings, commitments -- customized to meet the needs of individual participants in the education marketplace.

To ensure the continued participation of the nation's lenders through the decade of the 80's when the guaranteed student loan program became increasingly complicated, Sallie Mae devoted much of its resources to the development of sophisticated products that serve student loan lenders and provide better service to schools and students. Sallie Mae's development of a state-of-the-art student loan servicing system has enabled us to service, in-house, more than half of the loans we own and provide a full range of technical assistance products to lenders who want to participate in the student loan program but cannot afford the expense of developing the unique systems needed to properly originate and service loans. And, in this past year Sallie Mae's "back room" expertise -- our strong knowledge of the operational and administrative aspects of student loans -- combined with the authority granted to us by the Congress, provided much needed assistance to the Department of Education as it quickly moved to achieve an orderly wind-down of the Higher Education Assistance Foundation (HEAF).

Using authority granted during the last reauthorization, Sallie Mae has also launched a successful program of facilities financing for educational institutions. As a result of this initiative, we have financed or provided support to 121 institutions for a total of more than $1.6 billion. These funds have been used to refinance existing debt related to

construction and renovation, to construct new facilities, to acquire new equipment, and to refurbish facilities in need of repair. We have become a key player in ensuring that the infrastructure of American higher education keeps pace with the demands of the 1990's and the next century.

To fund our investments, Sallie Mae raises capital that would not otherwise be invested in higher education. Our issuance of short- and intermediate-term securities in the global capital markets, where the corporation has gained a reputation as one of the highest quality credits, has brought new investors to American education. By using a variety of often innovative financing techniques in both domestic and overseas markets, Sallie Mae has been able to borrow cost effectively and maintain a near perfect balance sheet, one in which the interest rate and maturity of borrowed funds matches the rate and maturity of investments.

Success, in our view, includes operating soundly with healthy profits. Those profits serve to attract equity investment in our business from the general public, and educational and financial institutions. Profits also provide the critical buffer to enable Sallie Mae to survive periods of economic adversity or to recover from unexpected losses. This latter use of profits constitutes one of the most significant aspects of the safety and soundness discussion. The fact that Sallie Mae returns nearly 80% of its healthy profits to its business is a major reason why we earned a AAA and were able

to survive a variety of externally administered economic stress simulations. These additions to capital strength in the past three years were: $192 million in 1988, $209 million in 1989, and $233 million in 1990.

The most crucial element of the prudent management of a financial institution, especially through its period of rapid growth, is its ability to develop or attract equity capital. This hallmark of conservative private sector financial management is one of the two most important concepts I would offer today. And, Mr. Chairman, this area is one where Sallie Mae is doing very well. However, to continue to have the capital needed to serve the growing need for educational credit, Sallie Mae must be widely and accurately seen as being able to continue to operate in much the same way it has since 1972. Sallie Mae's financial strength as seen by the markets is the principal reason that investors have had the confidence to provide an uninterrupted supply of credit for higher education, even when, as recently has been the case, a credit crunch has afflicted other sectors of the economy. Our ability to adapt to changing economic conditions, to identify and serve higher education needs, and to be financially strong despite national economic problems, confirms the extraordinary value of marrying private business to our public purpose objectives.

CURRENT LAW OVERSIGHT

Mr. Chairman, instead of resorting to the creation of a stifling regulatory bureaucracy, this Committee and its Senate counterpart thoughtfully included as a part of our original charter a carefully constructed system of checks and balances on our operations and a method to reduce federal involvement over time.

Current law provides for meaningful and effective congressional oversight and ample outside scrutiny of Sallie Mae's financial condition by the Treasury Department. In addition to approving all of Sallie Mae's debt issuances, the Secretary of the Treasury is directed by statute to "...keep the President and the Congress informed of such operations and financial condition of the Association, together with such recommendations with respect thereto as the Secretary may deem advisable, including a report of any impairment of capital or lack of sufficient capital noted in the audit." Sallie Mae is required to submit a report of our annual audit to the Secretary of the Treasury, who also enjoys access to all our books and records. Indeed, we believe Treasury's current statutory authority to oversee the safety and soundness of Sallie Mae to be considerably broader than its authority with regard to other government-sponsored corporations. In our eighteen year history Treasury has never raised with us a single issue with respect to our safety and soundness, and we are unaware of any reported to the Congress or the President.

Mr. Chairman, our charter also makes us subject to oversight from the education committees of Congress. With both committees, Sallie Mae has established a frequency and quality of dialogue that goes far beyond the formal reports required annually by our Charter. I believe that it is largely as a result of this history that the Congress has been willing to broaden our authorities on some occasions, and to constructively caution us on others.

It also needs to be understood that, as distinguished from others, Sallie Mae is essentially engaged in supporting an activity that is itself created and intensely regulated by the Government. Accordingly, Sallie Mae is reviewed from time to time by the Department of Education's Office of Inspector General and Division of Audit and Program Review and by state guaranty agencies in regard to its holding of GSLP loans, and by the Department of Health and Human Services on its HEAL loan portfolio.

I have attempted to summarize the extensive, official oversight of Sallie Mae under current law, not including the ongoing ad hoc reviews by GAO, CBO, OMB, the Treasury and others. But as you know well, Mr. Chairman and Members of this Committee, Sallie Mae lives in a sizeable fishbowl. As a publicly traded corporation, we are subject to the rules of the New York Stock Exchange, the anti-fraud provisions of the federal securities laws, and the watchful eye of investors and analysts on Wall Street, as well as the credit-rating agencies like Standard & Poor's, the one which has

just rated us AAA, independent of any benefits of government-sponsorship. An independent, public accounting firm audits us annually and provides comfort on interim financial reports to investors. Our risks, profitability, policies, and management practices are analyzed continually by our debt and equity investors. Our many competitors and others in the higher education marketplace scrutinize our actions, and report directly to you on Sallie Mae.

Finally, any summary of current oversight of this corporation would be incomplete without reference to its significant internal controls. Internal scrutiny starts at the top, with the governance structure fashioned by the Congress. Our 21-member Board has a fiduciary responsibility to ensure the safety and soundness of Sallie Mae's operations. Management is accountable to this Board, 14 of whom are elected by the shareholders and 7 of whom are appointed by the President of the United States. The President also designates the Chairman of the Board. And, mindful of the need to strengthen Sallie Mae's accountability, we are seeking in this reauthorization an amendment to our charter that would strengthen further the governance of the corporation by giving all Sallie Mae's shareholders voting rights. Such an amendment will not only intensify the market discipline on Sallie Mae management and directors, it will also enhance our ability to raise capital.

WHERE DO WE GO FROM HERE?

As an active participant in the reauthorization of the Higher Education Act, Sallie Mae is confident that with your support we will continue to bring our considerable financial strength and entrepreneurial creativity to meet the nation's requirements for various forms of postsecondary education credit. However, despite our consistent success, there are some who are setting aside the conclusions from the studies that we are safe and sound and are calling for drastic regulatory proposals.

Mr. Chairman, Treasury's legislative proposal which you have heard today came as a surprise to us. On the one hand, Treasury reported that Sallie Mae was awarded the highest possible stand-alone credit rating from Standard & Poor's, AAA. And Treasury has consistently maintained over the past year, and most recently in its April report, that a government-sponsored enterprise which enjoys a AAA rating "will be exempt from regulatory capital requirements and the frequency of reports and examinations may be reduced."

But the legislative expression of the Treasury report now proposes that even in instances where Sallie Mae is scored at the highest level by two different independent rating agencies, the Secretary of the Treasury can still intervene in the management of the company. The extremely broad discretionary powers Treasury cedes to itself could

be highly disruptive to the program. There is no question in my mind that the existence of such broad authority could impair Sallie Mae's ability to attract capital for investment in the GSLP and could raise questions concerning the contractual strength of the purchase commitment agreements we have with lenders. And, in this regard Mr. Chairman, Sallie Mae's purchase commitments are the cornerstones which many lenders rely on to support their continued participation in the program.

The Committee should understand clearly that the Treasury's legislative proposal would put in place the regulatory solution crafted for the long ailing thrift industry. While a long list of sound reasons can be offered to show why such a regulatory solution is entirely inappropriate for Sallie Mae, let me offer just a few:

1. There are thousands of thrift institutions scattered all across the country. The legislative remedy proposed by Treasury for Sallie Mae includes broad provisions taken directly from the FIRREA legislation which as you know was adopted to curb fraud and abuse after the widespread failure of thrift institutions throughout the country. By contrast, there is one and only one Sallie Mae; we are here in Washington; we have not experienced a single incident of fraud or abuse; and our chairman is appointed by and serves at the pleasure of the President of the United States. Moreover, we never have, nor as presently constituted will we ever represent an enforcement

challenge which is in any respect comparable to that encountered in the pursuit of the thrift institution excesses and fraud.

2. In the decade prior to the industry's failure, thrift institutions enjoyed widely broadened business opportunities. Their rapid growth into unknown areas of risk, their weak capital base, their failure to retain profits, and their lack of institutional controls were among factors which produced the need for FIRREA legislation. By contrast, Sallie Mae serves a very narrow business niche. Our growth has been steady and prudent and our investment in controls has come well before entering new business activities. Finally, and most importantly, our commitment to building equity has resulted in our attainment of risk-based capital levels well above those set for national banks.

3. The thrift industry regulatory mechanism was never equipped to deal with the growth and new ventures undertaken in the years leading up to the widespread failures. By contrast, Sallie Mae's narrow range of business and its very public nature make it far easier to oversee. Moreover the sources of control, the checks and balances listed earlier in this testimony, are many, diverse, and well suited to the oversight required.

The GAO's proposal, as described in their report and highlighted in testimony today would put in place a single, super-regulator. We believe that this approach is at best counter-productive to the goal of insuring that each GSE can someday match Sallie Mae's existing credit quality. The ratings provided by S&P were: Sallie Mae—AAA; Fannie Mae—A minus; Freddie Mac—A plus, and Farm Credit System—BB. The creation of a single regulator to supervise all GSEs will signal to the capital markets who purchase GSE debt that there is little credit distinction between GSEs and that their reliance in the event of failure is on the federal government. In other words, what is today an implicit guarantee would become an explicit guarantee. At the same time, the cost of equity capital would increase as recognition of our balance sheet quality diminished and fear of regulatory intrusion increased. The result would be to make it more expensive and difficult for Sallie Mae to attract the very kind of private sector "buffer" to taxpayer risk the GAO and others propose to reinforce. Our inclusion in a group of very dissimilar and less well positioned GSEs will force our corporation to manage to standards of the weakest GSE, for the weakest GSE will set the risk levels a super-regulator will expect us to meet in the conduct of our business. The combined effects of these factors could ultimately have serious consequences to students, other secondary markets, lenders, and postsecondary educational institutions.

THE DANGERS OF UNWARRANTED REGULATORY INTRUSION

These drastic regulatory proposals hold great potential for undermining the structure Congress has so carefully built to ensure available private capital. Crucial to the integrity of a private sector secondary market is its reliability, predictability, and discipline. When capital flows readily as is the case with the structure you created nearly two decades ago, it does so because there is certainty in the process and trust among the participants. Sallie Mae has become the central component of the steady flow of capital. The introduction of new, unpredictable, and perhaps unwarranted interventions, a clear consequence of both the Treasury and GAO proposals, represents the type of change that financial markets may neither trust nor readily accept. As importantly, the perception of program participants may be badly shaken. Sallie Mae's ability to be ready under all economic and political conditions is one of our most important contribution to ensure availability of educational credit.

Mr. Chairman, the second key point in this testimony is one which I wish to ensure that there be no possible misunderstanding as to its consequences. The proposals put forward would create a highly discretionary intervention mechanism, one outside your Committee's control. From our perspective, it is one with truly unlimited power, and one which could be administered by those with very little program knowledge. The presence of an entity so empowered could irrevocably alter and de-stabilize the

structure you crafted. It could provide a direct, unpredictable means for Executive Branch intervention, perhaps motivated by a crisis in another industry that has nothing to do with education finance. Or worse, such a regulatory intervention may be triggered as a result of dissatisfaction with the program policy objectives you would have us support. Had such regulations been in place in the past, it is doubtful that Sallie Mae, in spite of its willingness to act, would have been permitted to respond to meet Congressional or Department of Education objectives.

Not only would such regulation tie our hands in meeting the needs of the marketplace we serve, it would accomplish the contrary of its stated objective. Proponents hold the position that more regulation would somehow decrease risk to the taxpayer. In our opinion quite the contrary would be true. Through the proposed expansive regulation, the government would become increasingly accountable for what Sallie Mae does, and any implicit guarantee would become explicit. From management's point of view, with the ever present threat of regulator intervention, and its totally discretionary power to pre-empt decisions and remove officers from employment, the single most predictable consequence of proposed regulation would be a sudden denigration of entrepreneurial spirit and a rapid slide down to the comfort zone of mediocrity. One either turns the keys of the business over to the regulator or one manages to the level needed to avoid any possible pretense for its discretionary intrusion. In neither instance will this program be well served.

THE NEXT STEP

We are not a lone voice in citing the risk and cost of heightened regulation. Nor are we alone in believing that Sallie Mae's unique financial strength affords you, the Congress, other means of dealing with us. For example, the Congressional Budget Office pointed out:

> The Student Loan Marketing Association (Sallie Mae), which provides financing and liquidity to the market for student loans, exposes the government to a negligible amount of risk at present. The principal policy issue with respect to Sallie Mae is what action -- _if any_ -- the government should take to prevent the enterprise from increasing its exposure to risk in the future. (emphasis added)

Mr. Chairman, your Committee has the prerogative of leaving the structure you have built in place. The CBO has highlighted some of the reasons why Sallie Mae's low risk profile and financial strength would support a conclusion that the existing oversight structure is sound.

> Because Sallie Mae poses so little risk to the government today and has strong incentives to continue to operate in a low-risk manner, there are no guarantees that the potential benefits from effective supervision -- prevention of greater risk-taking by GSE -- are worth the potential costs associated with poorly informed supervision.
>
> Although no single federal agency has specific regulatory responsibility for Sallie Mae's safety and soundness, the GSE is subject to operating restrictions and oversight. The most important is probably periodic Congressional oversight. Congressional review of Sallie Mae's operation exercises an important influence on management...The Secretary of the Treasury also has statutory authority to

> examine all financial records of the association. The Secretary is required to report annually to the President and to the Congress on the financial condition of Sallie Mae.

Additionally, the CBO states that with respect to Sallie Mae, there is no urgency.

> The lack of urgency in the case of Sallie Mae stems from the fact that the firm -- without a safety and soundness regulator -- has conducted its business in such a way as to have limited the federal exposure to an insignificant level. Sallie Mae has carefully controlled its risks and maintained a level of capital that seems to have been appropriate. A well-informed regulator would have required exactly this type of behavior... [April, 1990, CBO Report, pp 260]

Mr. Chairman, I believe that this Committee, with its experience in overseeing programs supporting American higher education, is uniquely qualified to judge how best to assure that Sallie Mae continues to perform its mission in a manner which maintains financially strong operations, posing no risk to the American taxpayer. I urge you to reject solutions devised for some other industry's problems which would impede Sallie Mae's ability to act quickly and creatively in response to programmatic initiatives requested or supported by our Congressional overseer. I urge you to reject the proposed structures, lest they be enacted and transform Sallie Mae into a corporation that manages its business for "the safety and soundness regulators." That style of management has not served other industries well and would be in stark contrast to the attention management now gives to properly balancing marketplace risk pressures and our public purpose. The legitimacy of this concern w·s foreshadowed in the 1985 report of the Congressional Budget Office (CBO): "Regulation aimed at locking Sallie Mae into its present low-risk mode of operation would probably put an end to its

innovative product and service development efforts. Management turnover would probably increase if a static environment was imposed."

We strongly believe it is largely because you established Sallie Mae to work in the private sector with its tradition of innovation and prompt responses to marketplace needs that many of the program objectives you sought have been accomplished. In the past these have included: providing lenders with commitments to purchase the loans that they will make in future years; developing new products and services for students and lenders as their needs required; helping small lenders stay in the business of offering guaranteed student loans; developing financing instruments to assist other secondary markets and lenders; and providing a new source of financing for academic plant and equipment when governmental resources could not accommodate them.

Mr. Chairman, as you and your Committee now look ahead to the postsecondary education financing challenges of this decade and the next century, you will need a proven source of innovation and change. I am well aware of the developing programmatic needs: programs for the middle class, a simpler Stafford program, support for non-traditional students, fail-safe contingencies for major parts of the present delivery system, to name just a few. We are confident that after thoughtful consultation with your committee Sallie Mae will be able to provide critical support to those emerging needs however you choose to solve them. Moreover, as you are aware, under the present statute, to undertake special initiatives, should the Secretary of

Education determine a situation in the industry warrants such action. With respect to both existing and future authorities, it is important to understand how severely limited would be our support in the future if your Committee does not successfully counter the regulatory proposals you have heard others support today.

Obviously, Mr. Chairman, I am very eager to join with you and this Committee to fashion a solution which we both can feel confident will ensure Sallie Mae's continuing support of higher education. It should be a solution that draws from our strength and not one which falls prey to unfounded speculation about the future. Mr. Chairman, at the risk of appearing to be melodramatic, the burden of my testimony today is that this Committee should avoid the siren voices of the Treasury Department and the GAO which would, in our judgment, without justification, be tantamount to the reversal of the original decision to rely on the private sector to support the GSLP. We believe the effect of these proposals would be to make Sallie Mae behave like an agency of government. This would destroy the carefully constructed balance between our public and private purposes which has been the hallmark of our success.

I look forward to working with your Committee and would be pleased to answer any questions you may have.

Chairman FORD. Thank you very much.

I have kind of a general question that anybody can respond to. Just why is regulatory consistency, which in this case is the simple statement of treating all GSEs alike, essential? Regulatory consistency is basically a policy that would treat things that are vastly different in the same manner, rather than regulating each GSE in a way that is appropriate to its size, mission, and risk.

Our examination of the Treasury proposal indicates that it seems like a classic example of the proverbial cast iron fly swatter. I don't know how you take unlike entities like these and come to the conclusion that the immutable end objective is to treat them all the same. That makes about as much sense as does adopting an education policy and saying that all students, regardless of their strengths or weaknesses or needs or the purpose of the education, as perceived by them, ought to be treated the same.

When we say "treated the same" about students, we talk about not getting unduly intrusive into their own decision-making process and treating them fairly, and I don't think anybody at the table sees what is suggested by Treasury as any different. But falling back on something I have heard ever since I came here 27 years ago, if we've got something that works, and nobody says it isn't likely to work, why are we fixing it?

Mr. Basham, could you give me some help on that?

Mr. BASHAM. Sure, Mr. Chairman. In terms of regulatory consistency, the approach that we took was——

Chairman FORD. Please don't use that term "regulatory consistency." I just told you why I think it's an oxymoron. Regulatory consistency is what I learned in elementary accounting in undergraduate school, and that means that you have the column on the left match the column on the right. That's regulatory consistency, and it's dumb. Any idiot can do that.

We are talking here about an agency that was created by this committee because there was nobody else in the business, and we had a program that wasn't going to get off the ground unless we constructed for ourselves a unique system which now is known by the acronym of Sallie Mae. I am almost an expert on its beginning because I opposed it. It really is the product of a Republican on this committee, Mr. Erlenborn of Illinois, who worked for a long time to convince us that we were never going to make this student loan program work if we didn't create our own bank.

I didn't have a very fond feeling for creating, helping, or even having anything to do with banks, but we were finally convinced that it was an essential element of the program. What has always been important to us is not Sallie Mae, who runs it or who the President appoints over there. We have never interfered in that in any way at all. We don't care what they do as long as they are there when we need them to make sure that our train runs on time. In the case of this committee, the trains that we want to run on time are the Guaranteed Student Loan Program.

Now, I hope I am not conveying too much anxiety to you, but I get understandably upset if somebody wants to come and play in our puddle and say, well, everything is going fine. They are doing what you set them up to do. And, as a matter of fact, most recently they have helped us avoid real serious problems across the country.

But now Treasury would like to come and tell them how to do it better.

Treasury is already in the ball game, but you gave us a list of all the things that Treasury wants to do in addition to that, and a couple of them suggest to me another level of decision-making interposed between this committee and our creature, Sallie Mae. We are somewhat jealous of the relationship that the committee has continued to maintain during the 18 years of Sallie Mae, and we have several times made significant changes in their mission and their goals without getting involved in the day-to-day operation over there.

I would like to know how you feel that operating a specialized agency such as Sallie Mae, which has only one reason for being— I'm surprised, Mr. Blum, when you talk about privatizing. If you want to talk about privatizing Sallie Mae, I can privatize it for you in this reauthorization. We will just abolish it.

Because if Sallie Mae is privatized and no longer has as its total reason for being the Guaranteed Student Loan Program, it isn't what we created, it isn't what we wanted, and we don't want another bank, good, bad, or indifferent; we want an agency that has as its fundamental mission support of the Guaranteed Student Loan Program.

So I guess the easy way for us to respect the direction to legislate by September, we can simply take the suggestion to privatize it. We'll just dump it. Now, I don't know what the impact of that would be on your feelings and your bookkeepers' feelings about symmetry and regulatory consistency, but I know what it would do to the Student Loan Program, it would bring it to a screeching halt.

This committee is more concerned with action by Sallie Mae that impinges on access to student loans by people seeking education than we are about how the bookkeepers feel about regulatory consistency. And we are going to continue to do that. Now, my understanding is we do have to legislate something before September. I am not at all sure what happens if we don't, unless somebody else tries to legislate, and then we have one horrendous turf fight around here.

Do any of the other agencies that are being treated with this regulatory consistency enjoy the same rating with the rating agencies as Sallie Mae?

Mr. BASHAM. The only other GSE, Mr. Chairman, that was rated triple-A was the Federal Home Loan Bank system. I think you could characterize their oversight of their safety and soundness as quite extensive, particularly with respect to Sallie Mae.

Chairman FORD. Why does Treasury feel that the present authority that it has in Sallie Mae is not adequate to assure safety and soundness?

Mr. BASHAM. Currently, Mr. Chairman, Sallie Mae—our authority is nominal at best. We can ask for their annual report to be submitted to us. If their independent auditor within that annual report makes note of any impairment of capital or any things that they are concerned about, the Secretary has a responsibility under the law to communicate that, both to the President and to Congress.

We should be sending up to this committee, I think sometime shortly, the letter that we send every June, which includes our assessment based on the assessment of the independent auditor in their annual report. Beyond that our only other real authority of consequence, besides the ability just to go in and look and their books, is the ability to control, to a certain extent, their access to the debt markets.

We have historically not used this authority over Sallie Mae or over any of the other GSEs in anything other than sort of a traffic cop function; i.e., to try to let them know what the Treasury itself is doing as well as what other GSEs are doing. And to the extent they decide it is inappropriate or unwise for them to come to market at a particular time, they make that decision themselves.

There is one current situation in front of Treasury where they had recently proposed borrowing some money off shore. We are having our tax people as well as our international affairs people analyze that particular borrowing. That would be a rare, rare exception to our traffic cop function.

But beyond these sort of nominal authorities, there is no general rulemaking authority. I would say Sallie Mae, for the most part, has complete discretion with respect to the level of capital it chooses to maintain for itself, the complete level of discretion with respect to how much risk it chooses to take in its business activities. Fortunately for us, for the taxpayer, for this committee, and for everyone involved, that level of risk is low and has been historically low.

I think we feel that maintaining the status quo presumes that we can foretell what the future is going to be. We don't profess to be able to do that. I think we would feel more comfortable, given the discretion that Sallie Mae currently has—in essence, some people would suggest they have a government credit card that they are able to use with no spending limit on it.

Chairman FORD. Wait right there. You just turned the corner on me, and I want you to understand where you're going when you turn that corner. You acknowledged that you can oversee what the auditors find in examining the way in which they are doing business, and that you have the authority and you do in fact use that authority to notify this committee when you see some indication that they may be deviating from what anybody, the auditors or Treasury, believes to be sound business practices.

Now, what I am concerned about is why you want to be able to make decisions at Treasury about those business practices without consulting us or the board of directors of Sallie Mae; in other words, to be able to veto an action of Sallie Mae, even if it is something we have asked them to do?

Mr. BASHAM. Mr. Chairman, I would characterize that as probably not our approach, quite frankly. We probably feel very strongly that heavy-handed regulation is counterproductive, particularly with respect to a GSE like Sallie Mae that is so well capitalized and so well run, in terms of its exposure of the taxpayer.

We feel that the intrusiveness of regulation should be inversely proportional to the risk that the GSE poses to the government. I think the legislation that we set up reflects those views, in terms of both the provision of a safe harbor for Sallie Mae, as well as as-

suming that they meet the capital standards that would be promulgated, and we have no reason to believe, based on our analysis, that they would not be able to meet any reasonable level of capital standards that might be promulgated, there is no room for intrusiveness on the part of the regulatory body.

Again, we feel strongly that heavy-handed regulation would be counterproductive. We don't want to run this business. Our preference would be not to run this business. Our preference would be for Congress to determine the programs, the programmatic issues that they want Sallie Mae to address.

Congress determines there is a targeted beneficiary. We want this particular group of Americans to be served by this particular GSE. We would support that. Our only concern is that, once Congress has made the programmatic decisions, that Sallie Mae does it prudently and with as little risk to the taxpayer as possible. We would not anticipate——

Chairman FORD. Do you foresee, for example, when you talk about authority to dictate standards, the situation that has arisen in recent years with a guarantee agency that became, on its books, overburdened with a population of low-income students in proprietary schools and found itself getting into trouble? We knew that trouble was developing, we know why, and it has more to do with the type of person that is being served by those loans than it has to do with anything else.

You are faced with a choice: We either quit protecting and affording education to low-income people because they are bad risks, or we continue. We asked Sallie Mae and the Secretary of Education to step in. Sallie Mae did, and we had practically no interruption in flow of access to loans to low-income people in the parts of the country, including the District of Columbia, that would have been shut off.

Now, what if your people at Treasury decide that taking over that kind of a risk is not a good business investment? I can tell you right now it's not a good business investment. And if all I was worried about is the business investment side of it, and that's what I'm afraid is all Treasury is worried about, I would have no trouble telling them, "Don't take this over. Let them flounder."

But since I am concerned that we are even-handed about educational opportunity for good risks and bad risks, and in fact we are in this business to remove capital risk as an impediment to education for the less fortunate, then I would tell them, "Do what we put you in business for, and don't worry about the fact that you are not going to make as much money out of it."

My problem is, at that point, whose regulation wins, yours or the desires of this committee?

Mr. BASHAM. Mr. Chairman, to the extent that this committee had Sallie Mae serving a particular public beneficiary, whether it be low-income, moderate-income students, in trade schools, in medical schools, or wherever, that's a decision that the Congress itself would make. Our only goal would be to make sure that they in fact are performing the services with minimal exposure to the taxpayer. That's it.

We would not dictate in the particular instance that you are referring to. They were performing as Congress intended them to

perform. Our role there would be strictly as a function—and we identified the potential exposure, the guarantor exposure in our 1990 report. We mentioned that in a couple of places, and in fact it did come to pass. It was handled, we think, expeditiously. S&P commented to us that the way it was handled was done extremely well. That was fine.

Our concerns were not that they shouldn't be doing that, because the decision had already been made by Congress for them to serve this particular program, this particular segment of the population. That's not our concern. Our concern would just be to make sure that in serving this particular segment of the population with a particular program that it be done safely and soundly.

Chairman FORD. We are going to have to go over for two quick votes, and we will be back as quick as we can. I would appreciate it if the panel could stay for other members to ask questions.

[Recess.]

Chairman FORD. There is a possibility there will be another vote. We will probably have Mr. Coleman back quickly. In his absence, Mr. Reed.

Mr. REED. Thank you, Mr. Chairman.

The issue of government-sponsored enterprises is a very critical one, because we all, I think, recognize the potential loss to the Federal taxpayer if we don't take appropriate action, but it is an issue which involves very complex financial markets, financial transactions, and I think it is useful, certainly for me, to try to understand more fully some of the premises that we are operating on and some of the objectives we are trying to realize.

The first issue—and my questions are general in nature, so I would encourage all of the panel to respond at will—at issue here, or why we are here, basically, is the implicit Federal guarantee for these quasi-public or quasi-private entities. I would just like a comment about the extent to which this implicit guarantee would require a Federal response.

In the testimony we heard that during the Farm Credit crisis in the 1980s, the Federal Government stepped in—but how explicit or implicit is this Federal guarantee? General comments would be appreciated.

Mr. FOGEL. Well, let me start, Mr. Reed, from a GAO perspective, you are correct that it is implicit. I think that history is the only thing that we have to go on. When there have been programs that have been set up where there is a very clear public policy purpose, as indeed is the case in the GSEs we are talking about, I think it has been our expectation that if things really got tough, you know, the government would step in, because we are dealing with public purpose types of enterprises.

So that's why we think the government does have an interest in assuring that, not intrusively, but assuring that these GSEs are operating in a safe and sound manner.

Mr. REED. Let me follow this up by a more detailed approach. There are various groups, constituent groups, if you want to use that term in the broader sense, that, in varying degrees, see the government as sponsoring these agencies. And, just for the record, among stockholders of this publicly-traded corporation, do you feel that there is an implicit recognition that the government will step

in, or do they recognize that there is no legal obligation for this government to step in?

Mr. FOGEL. I think, if you read the prospectuses of the GSEs and everything they say, they say there is no explicit guarantee. But the way the market behaves indicates that the market does understand that there is an implicit guarantee that the government would step in.

Mr. REED. Just, again, to continue, about bondholders, you would make similar comments?

Mr. FOGEL. I would say it would generally apply, yes.

Mr. REED. And then another constituent group, the actual student borrowers—in fact they actually have a guarantee, or at least they are borrowing with a guarantee.

Mr. FOGEL. Right. That's right. That's why it's called the guaranteed program, so they know they are covered.

Mr. REED. There is another issue which is sort of the flip side of the proposed regulations.

Right now we are talking about an implicit guarantee. In effect, if we pass significant regulatory authority for the Secretary of the Treasury or anyone else, that implicit guarantee becomes much more explicit, because the government is taking a firmer grasp of the institution and in effect is saying, not only will we guarantee these particular loans, but we will be guaranteeing the continuity of Sallie Mae.

Is that a fair judgment?

Mr. FOGEL. I think, from our perspective, I don't know that we think the legislation would necessarily guarantee the continuity. I think what we view it as doing is saying that the government has an interest in assuring that organizations that were set up for a public purpose and have a potential draw upon the Treasury are operated in a safe and sound manner. But, I don't know, maybe Treasury has some different views on that.

But I don't think we view this as having it set up so that the legislation would explicitly guarantee either the existence of these organizations or say that therefore the government would now explicitly stand behind what they do.

Mr. REED. Not cutting off Mr. Basham, but it seems to me that right now we are here because there is an implicit guarantee, because of historical events, because of market behavior, and yet we are proposing to take much more definitive regulatory steps. I would suspect that if the market is responding now, based upon implicit legislative authority, that we certainly have to consider the effect, or should consider the effect, of more substantial regulation.

Mr. FOGEL. Yes. I think—I'm not the best person to speak on how the markets act—but I think one of the reasons we are here is that there is a general recognition that because this implicit guarantee for all the GSEs is out there that it is important to take a look and see whether the government's interests, not only on the programmatic side but on the safety and soundness side, are adequately protected.

I think the sense we got from our study was a feeling that at the present time we don't think the government's interests, from a safety and soundness standpoint, are adequately protected. It's nice to hear that, and I'm glad we're able to report that the GSEs,

almost all of them, are in very good shape; they are being managed well, but that's today. And our concern is that it is difficult to look into the future and say, well, because everything is okay today, we ought to just keep our fingers crossed and say things will be okay a couple years from now.

Mr. BASHAM. I was going to address your questions with respect to making the implicit guarantee more explicit.

As we perused all the various regulatory venues in deciding the approach that we wished to take with respect to GSEs, we saw certain consistent powers that were there, including utilities, public utilities, that are regulated by various State utility commissions, securities firms. Those are two instances that came to our attention where there is quite active and effective governmental regulation that in no way suggests to the participants in those markets that there is any sort of government guarantee.

More to the point, with respect to how the market perceives these securities, as someone who came from the financial industry before I came to Treasury, I can assure you that, when we would get the annual reports from these entities, we would file them away, but effectively, based on our experiences and our perceptions, the government, if things really got difficult, given the closeness of these securities to the government, that the government would probably step in.

I would suggest that the spreads that they are able to borrow over the Treasury curve right now are more reflective of liquidity concerns and less a function of any concerns about the underlying credit. As a matter of fact, we ve done some analysis at Treasury that would suggest that some . the GSEs who have been issuing a lot of callable debt as of late are effectively, when you factor in the value of that call, are effectively able to borrow money at rates better than the Treasury itself is able to borrow.

So I would suggest that the market's perceptions are that, irrespective of the Treasury's comments that there is no explicit or implicit guarantee, irrespective of the comments of the GSEs themselves that there is no explicit or implicit guarantee, the fact remains that actions speak louder than words. When the Farm Credit System experienced difficulties, the U.S. Government stepped up to provide assistance. And I think that provided, some people would suggest, a living embodiment of the implied guarantee right there.

Mr. REED. I have a—unless you wanted to answer, Mr. Hough?

Mr. HOU - Congressman Reed, let me put on the record the history of Sallie Mae on this issue. Around the middle of the 1980s, at the request of Treasury, we terminated a relationship that we had had, as long as it was made available to us, under which we could borrow from the Federal Financing Bank. Clearly, the debt that supports our programs that came through the Federal Financing Bank carried the explicit guarantee.

It was a very appealing opportunity for us, because we, for a long time, have stressed to our investors that what they can look to and only what they can look to is th^ corporation's capital. So in the action we took in leaving the Federal Financing Bank we made a giant st-ide towards meeting that objective.

We consistently, in all debt offerings and all the occasions in which we stand before analysts who are interested in both our debt and our equity, emphasize that the capital of this corporation represents the total recourse that they have, that there is no explicit guarantee, there is no implicit guarantee, and as long as they continue to invest in us they should do so knowing that we are not in any way, shape, or form relying on the government to come to our rescue. We believe that today as strongly as we have ever believed it. As to the question of whether or not our debt today enjoys the advantage of this implicit guarantee, it is deceiving to stack that question up by comparing Farm Credit, Fannie Mae, and Freddie Mac that do hold rates substantially below ours, but yet are borrowing at costs very close to ours.

To gain insight as to what stands behind the investors' motives in borrowing our debt at a fraction over Treasury, you have to look at the only two other major banks in this country that are triple-As, Morgan and Wachovia. When you compare our financing costs to their financing costs, and you can do it only imperfectly, because we are not in the market on the same day with the same instruments, but, generally speaking, you are going to find that our spreads are very close to those two triple-As.

So I would submit that the difference between U.S. Government borrowing and Sallie Mae's borrowing is more representative of the fact that the market understands that we are a triple-A and accords us the same safety and soundness that they accord to the two other triple-A financial institutions in the United States.

Having said that, it is very difficult to prove, because we are perceived to be an agency issuer, but as compared with the other GSEs, we alone can make the comparative study of where we stand with where two other major financial institutions stand on this question.

Mr. REED. Thank you.

I have a follow-up question I am trying to determine the government's exposure—and I don't want to simplify this, because I think it is a very complex field—but, basically, our exposure comes in the actual guarantees that we give to the borrowing by students. I am talking now, of course, about Sallie Mae, not the other GSEs.

It is my understanding that in the budget proposal that has been sent up this year, as a result of reforms, that we are beginning to recognize the discounted cost of these guarantees over time. My question is, if we are in fact budgeting for potential losses in the guarantee program, aren't we recognizing directly the potential cost that would be borne ultimately by Sallie Mae?

Mr. BASHAM. Well, the budgeting that takes place and has taken place is really a function of the Department of Education's guarantee of the loans. Obviously, if students default, the Department of Education has to have the money to make good on that loan. So that's where the exposure to the taxpayer is on that specific lending program. The exposure through Sallie Mae, obviously, in a situation like that—or to Sallie Mae—is minimal.

There was some question, obviously, when HEAF experienced financial difficulties. There were some provisions that would not have provided 100 percent insurance of the student loans that HEAF had originated, based on their default experience. In fact,

the government made good—the Department of Education effectively ended up making good on all of those loans, and there would have been no impact to HEAF or to Sallie Mae, from that perspective. So, really, the exposure to the actual student loans is really to the Department of Education.

I think what you were alluding to earlier was this issue of Federal credit policy reform, which has to do with whether the government services various constituencies, either through direct lending programs by the government itself, through guaranteed loans, or through some facility similar to a GSE, and what is the most efficient way to provide that benefit to the particular constituency.

Mr. REED. Let me just follow up on this question. If we, at least for the sake of discussion, concede that there is minimal risk to Sallie Mae because of the guaranteed loans, because that has been budgeted now and discounted forward, or backwards, depending on your sense of direction, what are the specific risks that Sallie Mae has run that require increased regulatory supervision?

Mr. BASHAM. Well, fortunately, the way they manage their business doesn't expose us to a lot of risk right now. Obviously, the major asset that they invest in are these guaranteed student loans, which are effectively guaranteed by the Department of Education. Ultimately, they are guaranteed by State agencies, but the Department of Education provides the reinsurance. So, effectively, there is not a lot of risk there. You are talking about a full faith and credit obligation.

Now there are other areas of their business. They do make warehousing advances that they have chosen to have collateralized.

Mr. REED. By guaranteed loans?

Mr. BASHAM. Pardon? Yes, they will make warehousing advances to institutions to make government-guaranteed loans, and those warehousing advances are fully collateralized. But there is some credit exposure there. There is potentially some interest rate exposure, although, again, given the structure of their business, when you have an asset that effectively, by statute, reprices its cost every 91 days, you don't have as much flexibility with respect to asset and liability management as you might have.

Again, we have said repeatedly, all of us, I think, and S&P, as well, have said that the structure of the business, the way it is currently managed today, does not pose a tremendous amount of risk. Again, I think our greatest concern is that we can't tell the future.

At one time in the past, Sallie Mae owned a thrift that it got rid of several years back. To the extent that they are inclined, at some point down the road, to do things like that—I'm not suggesting that they are going to—but we can't foretell the future. We would feel more comfortable having an infrastructure in place that could deal with these things when they arise.

Mr. REED. Our Chairman is being very patient. I have a few more questions, Mr. Chairman.

Mr. FOGEL. Congressman, let me just add one thing to that. There is another type of risk that we think has to be recognized for all GSEs and that is the management risk that occurs. Now, that is not something that you can determine by running a stress test or applying risk-based capital standards. That's why you need, we pro-

pose, a leverage capital ratio in there. That can be tied in somewhat with business risk.

Mr. REED. Let me just follow up Mr. Fogel. Going back to what Treasury said, they have indicated that they don't want to run Sallie Mae. Effectively, what you are saying is that the risk we might be ultimately be controlling for is the management of Sallie Mae; is that a fair conclusion, based upon your comment?

Mr. FOGEL. Well, it's one of the risks that you need to recognize that exists in any type of financial institution.

Mr. REED. Just so I don't lose this thought—the other institutions we are talking about, the GSEs, and particularly, if you move away from the GSEs, the thrift industry and the banking industry don't deal exclusively with guaranteed products like this.

Mr. FOGEL. No, that's correct.

Mr. REED. So we are looking at something unique, even within the field of GSEs; is that fair?

Mr. FOGEL. There is no doubt that the interest rate and credit risk for Sallie Mae are much lower than similar risks for the other GSEs

Mr. REED. Thank you.

We do have, I think, a problem here, and let me sketch out some thoughts I have for your response. First the most recent failure among the guarantee agencies which operate in conjunction with Sallie Mae was the HEAF. Are there any proposals to directly regulate the guarantee agencies? If the problem is not at Sallie Mae, if the problem is at guarantee agencies, are we picking the wrong target simply because they are the one that is most easily regulated? That's one issue.

Mr. BASHAM. Well, effectively, as originators and servicers of student loans, they have some involvement with the Department of Education, who monitors those programs quite closely. I think they have a powerful incentive, again, given the way the insurance was changed back in 1986. Heretofore, there had always been 100 percent insurance by the Department of Education, irrespective of the default experience.

They found that the default experience in some of these guarantors was so high, they felt they needed some incentives. So, depending upon their default experience, that insurance coverage can go down to as low as 80 percent. This was the problem with HEAF. So there is incentive there. There is oversight of the programs from the Department of Education.

Obviously, I think we are all cognizant of the fact that if you make a particular type of loan to a particular student in a particular type of school, that it probably, with respect to all student loans, has a much higher risk profile. But, again, that is not to suggest that they shouldn't be made; it is just that they need to be made within the prudent confines of not jeopardizing these guarantee agencies. I think that is what the Department of Education is hoping to accomplish with this new reinsurance provision.

Mr. REED. Just another question that goes to the nature of the product. Unlike other financial institutions, and unlike other financial products, there is no real underwriting or diligence done before the extension of a loan. That is by Federal law. If you qualify under the statute, you get the loan.

And little is done—in fact, we are wrestling with that issue in the Title IV hearings, how do we, Congress, control the default rate, which is really driven as much by our specifications of who qualifies rather than the financial institution? In effect, then, are you trying to control us?

I don't want to be facetious, but we are the ones who specify who gets the loans, and we haven't specified an ability to pay or an ability to repay or the prudent lending standard. What we do is, at the tail end, we make the institutions, the lenders, go through hoops to collect, basically, not to underwrite, but to collect.

Mr. BASHAM. Well, effectively, Congress makes the programmatic decision that they want this program to succeed. And, again, now, that can be accomplished either by providing a direct subsidy, a guaranteed loan, or some other facility. To the extent that Congress realizes that these loans are of a highly risky nature, and there is going to be, on a percentage basis, a greater incidence of default than there might be with some other programs, Congress is prepared to assume that risk and appropriate the necessary monies to make up for the default experience. That is certainly within the province of Congress to do.

Mr. REED. One final question, observation, et cetera, is that, to the extent—I know, Mr. Fogel's and most of the proposals, the Treasury proposal see as one solution an increase in capital relative to assets, an increase is the equity ratio. That is, I think, a fair description of the bulk of the proposals. The flip side of this, and we are seeing that right now in the banking community, is that one way to do that is you downsize your assets. Simply, you stop making loans.

We are enjoying a credit crunch—"enjoying" is a facetious term in my region of the country—and I think the Chairman alluded to this, that to the extent that we direct higher capital ratios, the flip side of that could be a decrease in the amount of lending authority.

And, stepping back a bit further, I wasn't there at the creation, but my thought is that what motivated the creation of Sallie Mae in the first place was a notion that there wasn't sufficient available credit for higher education loans in this country and that we were going to do that through Sallie Mae.

Have you considered the fact that one unintended consequence of these higher ratios, dictated by Treasury and not by the organization, is that there would be a decrease in credit availability for students trying to go to school, which contradicts, I think, what we are trying to do here in Congress, which is make college affordable for lots of people?

Mr. FOGEL. We certainly talked about the pros and cons in the GAO when we were coming up with our recommendation. I think a couple things drove us to where we came out. Number one was our concern that for most of the GSEs there was no required capital level. And we haven't reached a conclusion as to exactly what that level should be. In some cases, it may, if you go through and do the analysis, it may mean they need lower capital than they have now.

I think the thing that really drove us and concerned us, when we looked at these GSEs, is we had very large financial institutions that were setting their own capital. When you look at some principles of financial regulation, one of them that we wanted to follow

was, because the government had an interest, we thought it was important that it set capital.

Now, in setting capital standards, again, this isn't done by fiat. There has to be a lot of discussion, a lot of dialogue. You know, there are procedures that are followed. And we wouldn't anticipate that any regulator is going to be capricious in doing that, because you don't want to set capital levels at a point where they drive the institutions out of business.

Mr. REED. But, as a point of departure, I think you all recognize, I hope, that capital is related to the extent that they will lend, or will expand or contract their lending abilities, and that's—we are at one side urging college be available, access to credit, the American dream. On the other hand, I don't think we can say, without taking into consideration, you've got to raise capital, raise capital, raise capital. I just want that point clearly recognized.

Mr. BASHAM. Mr. Reed, if I could just respond. I think we are sensitive to that, as well. We have said from the very beginning that our goal here is to look after the interests of the taxpayer and, at the same time, have no programmatic impact, if at all possible.

And one thing that is, I think, fortunate about this whole exercise is, we are not dealing with failed thrifts or banks that have an insurance fund that is seriously depleted, we are dealing with relatively healthy institutions, for the most part. And to the extent more capital would be required—and, quite frankly, given the triple-A rating of Sallie Mae and the structure of their business, I can't imagine there would be significantly more, if any—but I think, to the extent that more might be required, there are number of ways besides downsizing that you accomplish that.

One, of course, the obvious one, is to issue equity. Very profitable company; very popular stock. Admittedly, management would prefer not to dilute the ownership of existing shareholders, but, again, we are concerned with the taxpayer. We are concerned with the public sector beneficiaries of Sallie Mae. Unfortunately, we can't look out after everyone's interests.

Mr. REED. Your concerns are legitimate and important, I recognize, though. I, again, want to thank the Chairman for his indulgence. I have just one final question.

The board of directors of Sallie Mae, many are appointed by the President; is that correct?

Mr. HOUGH. Yes, seven.

Mr. REED. Seven. Typically, the way we govern corporations in this country is through their board of directors, and I wonder, if in fact there is authority right now for the directors to be appointed by the President, whether those directors aren't conscious of the same concerns that you are raising and whether that regime of regulation is—I raise the question; I don't have an answer—is that sufficient in and of itself?

Mr. BASHAM. In some respects—it's interesting that you bring up the board. I think Sallie Mae has a significant benefit that some of the other GSEs don't have, as they do have a board of directors composed almost entirely or I believe entirely of outside directors. They have played an active role in the company. The chairman is appointed by the President.

But our analysis of the responsibility of the directors, even the presidentially-appointed directors, they have the same responsibilities that all directors have for any corporation, which is to ensure that the corporation honors its charter, that it performs profitably for the shareholders. They don't have any special—any baggage to carry with respect to overseeing the financial safety and soundness from the taxpayer's perspective.

They may have this implicitly by being presidential appointees, but, in fact, there is no explicit or legal requirement on the part of the directors, even the presidentially-appointed directors, to view the interest of the taxpayer above the interest of the shareholders.

In point of fact, according to our legal analysis, their primary fiduciary responsibility is to the shareholders.

Mr. REED. Mr. Hough.

Mr. HOUGH. If I could respond to that question, I hold a different view. I think this Nation has many, many private sector corporations that do extraordinarily well. They are overseen by boards of directors who in fact take to heart the liabilities they have in pursuing any activities that jeopardize the safety and soundness of those organizations.

With respect to Sallie Mae, our directors absolutely understand the exposure they have, as directors of a public corporation, and the need that follows with that exposure to tend to the business of safety and soundness. The chairman of Sallie Mae is appointed by the President. In assuming that position, he is acutely aware of the need for him to preside over an organization which is never a political embarrassment to the Chief Executive Officer of the United States.

I have sat in 18 years' worth of board meetings, through three administrations, and I can tell you that all chairmen and all presidentially-appointed board members keep as one of their foremost objectives the need to avoid any action which could be politically embarrassing to the President. They all also understand that they can be removed from office by the President.

Sallie Mae's board composition includes more appointed presidential board members than any other GSE and is one of the few GSEs where the chairman is appointed by the President. And, finally, the issue is not little management presence on the board, there is no insider position among our directors. They are all outside directors. I think there is a great deal of oversight safety and soundness cushion built into that governance.

Mr. REED. Thank you.

Mr. Chairman, thank you very much for the time.

Chairman FORD. Thank you.

Mr. Coleman.

Mr. COLEMAN. Mr. Basham, I guess most of my questions will be directed to you. I want to start off by saying that the concerns the Chairman has expressed, and I think others have as well, and in your own discussion today, you make the distinction, the differentiation between the GSEs and in particular, the one we are talking about here today. You do it constantly, and I guess that is our concern about this bureaucratic cookie cutter methodology used where all of them are going to be regulated, same requirements, and so forth.

You cite the Farm Credit System experience, and I was involved with that one as well. The fact that others, who are very sophisticated investors, I might add, look at these entities as, as you say, more governmental than private, always amazes me because these are people who have billions of dollars for investment purposes. And if they don't understand the agency status of these entities, who would?

I am not sure that the fact that we tried to bolster the Farm Credit System lends credence to it, other than to say it was a necessary thing to do under the circumstances and less costly than any forecast I saw at the time. Along with that, there have been a lot of changes and reforms in the Farm Credit System. The independence, if you will, of that system has been diluted by the political process because of the reforms we made, and the requirements we created.

I mean, there was a price tag involved. And I would suggest that there would be a price tag with this one, too, to the extent that this legislation goes forward. I don't know that we want to end up having Sallie Mae become part of a process which we have tried to insulate it from, I think, in most aspects.

Let me ask you this question: Who is it that we are protecting under your proposal? If Sallie Mae were to somehow announce today that they are in deep financial trouble, who are we going to be bailing out, if that's the word, under the circumstances? Would you please explain to me what liabilities are here?

Mr. BASHAM. Well, Sallie Mae has a number—I forget the exact number; I have it in my briefing book—but it's $39 billion worth of outstanding debt that is guaranteed by Sallie Mae. That number may be too high. But to the extent that, for some reason, Sallie Mae were unable to fulfill any one of its obligations, any one of the liabilities on the corporation, I think our concern is that the beneficiaries of Sallie Mae would look to Congress to rectify the situation.

Obviously, there are important beneficiaries——

Mr. COLEMAN. Let's stop right there. Are we talking about the stockholders?

Mr. BASHAM. No, the holders of these obligations. The stockholders, I can only assume, irrespective of the fact that the shareholders of the Farm Credit System were protected during that bailout, a lot of their at-risk stock was converted to not-at-risk stock. I can only assume, though, that most GSE shareholders would probably view their capital to be at risk, and I don't think they would look to the government to bail out shareholders at all.

But I think the holders of the obligations of any of these GSEs, if they were to, for one reason or another, be unable to fulfill on their obligations, there are serious consequences with respect to that.

Mr. COLEMAN. You are talking about bondholders, in this case?

Mr. BASHAM. Bondholders. And, to the extent that that eliminated the ability of Sallie Mae to go to the credit markets, it effectively shuts them down. They are unable to fulfill their public purpose intended by Congress. And to that extent, I think Congress would probably come under some pressure from all of the groups that have an interest in seeing Sallie Mae succeed to do something to rectify the situation.

Mr. COLEMAN. Too big to fail?

Mr. BASHAM. That's a term that some people have used. We have avoided it. But, effectively, some people have suggested, yes, these GSEs now are too big to fail.

Mr. COLEMAN. How big do you have to be before you can fail and not create a problem. We had a problem out in California recently with a servicer, and there were tens of millions of dollars at stake, as I recall. And yet Congress didn't rush in and bail out those bondholders or those people at all.

Mr. BASHAM. Well, I don't know how the servicer funded the loans that it made.

Mr. COLEMAN. He borrowed from Japan, from Japanese investors, as I understand it, who, as a result of this, are quite skeptical of investing any further in these programs or other investments in the country. So there you have your unsophisticated mega investor getting involved with something he claimed he didn't know wasn't supported and guaranteed by the government.

Mr. BASHAM. I think a big distinction there, Mr. Coleman, is that guarantee agency out in California was not a creation of the United States Government.

Mr. COLEMAN. But, as I understand your arguments today in answer to other questions, the real nexus of the involvement is the guarantee on the loans.

Mr. BASHAM. The exposure that Sallie Mae itself faces, from a credit perspective, is on the loans that it owns, and that exposure is effectively done away with by the government or the Department of Education guarantee. So the real exposure on student loans is to the United States Government, the Department of Education.

Mr. COLEMAN. Right. And it really doesn't matter if it is Sallie Mae, or "X" guarantee agency, does it? The exposure is there.

Mr. BASHAM. To the extent that Sallie Mae is a creation of the United States Government, the debt that Sallie Mae issues, for all intents and purposes, has all of the attributes, all of the unique characteristics that the Treasury debt, the debt of the United States Government, has, except the lack of the name and the full faith and credit guarantee leads investors to view these in a much different light than they would, say, the subordinated debt or the senior debt of, say, General Motors, or someone like that.

So, again, these GSEs are very unique entities, created by the government, and some people have suggested if the government created it, the government will support it.

Chairman FORD. Will the gentleman yield there?

Mr. COLEMAN. Yes.

Chairman FORD. The gentleman touches on a very important point.

After we created Sallie Mae, we saw a real mushroom patch of similar agencies develop around the country. Now, if it had been the other way around, if the money lenders would have come out of their temple in this country and started to support the Guaranteed Student Loan Program in the early 1970s, as we had hoped they would, we wouldn't have a Sallie Mae, because these other guarantee agencies would have all popped up around the country, and States like California that got into the business with gusto, would have all been in business and we wouldn't need Sallie Mae, so we wouldn't be sitting here today.

You have the cart before the horse when you pass quickly over what Tom Coleman is talking to you about. It really doesn't make any difference to the Department of Education, in terms of its liability, whether you are talking about a loan that is being ultimately serviced by a California guarantee agency, a Texas guarantee agency, a secondary market, or Sallie Mae. There is no real difference.

So why don't we worry a little bit about what they are doing out there, too? If in fact the failure in California didn't affect us, then why would the failure of Sallie Mae affect us? Except for the difference in size—and it wasn't tens of millions, Tom, it was hundreds of millions of dollars in California—except for the difference in size, what is the difference in principle?

Mr. BASHAM. Well, Mr. Chairman, I think the Department of Education is concerned. Again, they have direct, immediate, programmatic involvement with all of these agencies that make these student loans. Obviously, they are the guarantor of these loans, and they want to make sure that the program is done according to the wishes of Congress and done prudently. So I wouldn't suggest that we are overlooking them at all. That's something the Department of Education focuses quite a bit of resources and effort on.

Our concern is with Sallie Mae. Sallie Mae, as you rightly observe, basically created this market. Heretofore, banks were reluctant to make these loans. They were bad credit risks. And even though there was a government guarantee, they were illiquid; they had to make them and hold them. Sallie Mae came along at the right time; in essence, developed this market, which led to the creation of these other guarantee entities.

But, again, Sallie Mae does operate differently from them. We are not as concerned about these guarantee agencies, because, again, they are effectively overseen, their programs are overseen by the Department of Education, who has the immediate, direct exposure.

The exposure with Sallie Mae is somewhat different. Admittedly, it is relatively small currently, given the nature of the assets and the way they run their business. But, effectively, if the Department of Education has no oversight over Sallie Mae, our concern with Sallie Mae is that they run the portion of this guaranteed loan business that Congress has instructed them to focus on in a prudent fashion. So far they have done that.

Mr. COLEMAN. Well, you have, currently, some oversight role, and I'm not sure it is even exercised. Let me ask you another question, in your proposal, you have this triple-A rating. If you go out and get a triple-A rating, you are not automatically put in a safe harbor. You still have discretion to deny that; isn't that true?

Mr. BASHAM. That's correct.

Mr. COLEMAN. Why do you require further discretionary reasons to require Sallie Mae to jump through a hoop before it can come into the safe harbor condition?

Mr. BASHAM. I think, originally, it was not our intent to do that. If you remember our proposal from last year, our proposal was that anyone who was triple-A effectively had minimal regulatory oversight. As we went through the administration's clearance process on this piece of legislation, some of the attorneys within the admin-

istration expressed concerns about the presidential appointment clause.

To the extent that this director or the Secretary is appointed by the President, the Secretary would effectively be ceding some of the president's power to an outside private sector entity. I am not an attorney. I know the issue was raised. I am not suggesting that our attorneys are right or wrong, but I think, as a result of that concern, it was something that had to be left to the discretion of the Secretary.

Mr. COLEMAN. Is there a substantial difference between double-A and triple-A? What is it?

Mr. BASHAM. In terms of capital, there is a substantial difference. It can take considerably less capital to be double-A. I think, in terms of default experience, the studies that have been done on default experience with these entities show that, as you go from triple-B, to A, to double-A, to triple-A, you experience less and less default experience.

The biggest pick-up in default—the biggest positive pick-up in terms of default experience; i.e., reduction in default experience, takes place when you go from triple-B to single-A rated, which would be considered sort of middle investment grade, then appreciably less when you go to double-A, and then appreciably less when you go to triple-A.

So there is not a lot of—I wouldn't say there is a dramatic amount of difference in default experience between double-A and triple-A, but in terms of the capital that it would require, it probably could be a substantial amount.

Mr. COLEMAN. You know, the concern that we have, if it hasn't already been articulated, is that you would have the control, through the regulatory process, of Sallie Mae, and that, if you felt that the make-up of the portfolio or some of their actions regarding these guaranteed loans was not to your liking, you could, through the back door, effectuate change in these programs because of the massiveness. Here's the 800-pound gorilla we've got here. Because of that, you could make a substantial impact on programs.

And we would basically have no oversight or authorization power over you to do anything about it. You understand that? I mean, I know you come here with good intentions, and perhaps so has everybody who has worked on this, but, when things become law, sometimes 10 years down the road, 15 years, a new crew comes in and they could have a whole new agenda, you are giving them legal authority to do it.

Mr. BASHAM. To a certain extent, Mr. Coleman, you are correct. Again, as I have indicated, we feel—and if you are familiar with our banking bill—the concept of regulatory intrusiveness is inversely proportional to the level of riskiness of the institution. Clearly, with an institution structured and managed the way that Sallie Mae is, we would, quite frankly, hope there was nothing for us to do, to the extent that they are in this safe harbor.

I think, though, Congress and the administration would want to feel that someone was not asleep at the switch, per se, but someone was there just to make sure that, if it was a question of the company continuing to be managed the way it is managed, that at least that effectively is happening. Clearly, the Congress has to make a

decision. Does Congress want to retain that authority itself, or would Congress feel comfortable allowing somebody within the Executive Branch just to maintain some oversight authority?

Mr. COLEMAN. Well, we have to vote. But I can imagine, for example, you lumping all of these together, and your regulations are the same for all of them, and then, eventually, it is like the banks coming to us, the ones that were conservative and doing the right things are being assessed to pay for the sins of the other ones. I bet that could possibly happen here in the long run.

Mr. BASHAM. Mr. Coleman, we have tried to work hard to make sure we did not lump them all together. That's why we have taken the approach that we have. They would be regulated quite differently, I think, in terms of oversight.

Mr. COLEMAN. Thank you.

Chairman FORD. I don't know if we have other members who want to continue the questioning who are on the floor awaiting this vote or not. If you could hold on until I check over there and call back to Tom, we may dismiss the panel. If not, we would ask you to take a 15 minute break and come back and see us. We will dismiss it, if we can.

[Whereupon, at 12:30 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

[Additional material submitted for the record follows.]

To be included at the end of Transcript

Suite 250, 700 Thirteenth Street, NW, Washington, DC 20005, Telephone 202 393 1650 or 800 833 9400

American College of Physicians

STATEMENT OF THE

AMERICAN COLLEGE OF PHYSICIANS

SUBMITTED FOR THE RECORD

TO THE POSTSECONDARY EDUCATION SUBCOMMITTEE

HOUSE EDUCATION AND LABOR COMMITTEE ON

STUDENT LOAN DEFERMENT

JUNE 19, 1991

Student Loan Deferment for Medical Residents

STATEMENT OF
THE AMERICAN COLLEGE OF PHYSICIANS
SUBMITTED FOR THE RECORD TO THE
POSTSECONDARY EDUCATION SUBCOMMITTEE
HOUSE EDUCATION AND LABOR COMMITTEE ON STUDENT
LOAN DEFERMENT
FOR MEDICAL RESIDENTS

June 19, 1991

Student Loan Deferment for Medical Residents

The American College of Physicians, representing 70,000 specialists in internal medicine and its subspecialties, strongly supports the legislation (H.R. 179) introduced by Congressman Penny to allow the deferment of payments on federally-insured student loans during medical residencies. Almost a third of ACP's membership are Associate Members, the majority of whom are residents. These 20,000 individuals are the future of internal medicine and our statement is made today on their behalf.

Prior to the passage of the Omnibus Budget Reconciliation Act of 1989, medical residents in university-based institutions were allowed to defer payments on their loans throughout the duration of their training. In an effort to address the inequity of granting "student status" to these residents and not to residents training in community hospitals, "OBRA '89" established a two-year deferment period for all residents regardless of the training locus. The College supports the equal treatment of medical residents but believes the deferment period must be extended for these

reasons: to avoid a rise in loan defaults; to keep the profession of medicine open to all individuals; to ease the burden of repayment that falls especially hard on minority residents; and to reduce the necessity to "moonlight," which has implications for the quality of care by already overworked residents. And finally, the College raises the issue of the impact of indebtedness on the overall attractiveness of internal medicine.

Issues Related to Loan Affordability

The education and training of a physician is not complete after four years of medical school but usually extends to a three-year residency for medical specialities such as internal medicine and pediatrics and a five-year residency for surgical specialities. The requirements for certification in a specialty are increasingly considered a minimum standard as the pressures increase to ensure that physicians maintain a high level of competency. Specialty boards are moving toward time-limited certification, and Congress has given serious consideration to federal re-certification requirements.

To comply with the new requirements contained in "OBRA '89," residents must begin loan repayment during the third year of residency. The combination of high levels of debt and relatively low stipends make it unrealistic for a large percentage of residents to meet their obligations. Over 80 percent of the 1989 medical school graduates have an average debt of $42,000; 32 percent of graduates owed more than

$50,000. In the third year of residency when loan repayment begins, the mean stipend is $28,577.

To comfortably repay a loan, lending agencies suggest that payments not exceed eight percent of gross income. The Association of American Medical Colleges (AAMC) Survey of Third Year Residents provides an interesting example of the difficulty of repayment during residency and in the early years of one's professional life. The case study illustrates the 11 percent of medical students who have a $75,000 debt. The interest and principle payment on this debt, from Stafford, SLS and HEAL/ALP sources, would total $971.53 a month. The annual salary needed to retire the debt comfortably would be $145,000; difficulty would arise at $97,000; and repayment would be impossible at $73,000. With stipends less than $30,000 and first year incomes after residency of $80,000 or less for many primary care specialists, the risk of loan default is apparent. This simple comparison of debt and income tells only part of the story as the following description of a "cash flow" study illustrates.

This 1990 study of student loan indebtedness, published in the Journal of the American Medical Association (JAMA), evaluated the effect of varying levels of indebtedness on the cash flow of a "typical" resident. The authors conclude that "Numbers such as 'average reimbursement' and 'average indebtedness' have been reported, but are cumulative and do not convey the effect of educational indebtedness on the cash flow of a typical house officer." A simple comparison of level of debt

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and potential income can be misleading. One example from the attached table shows that a typical house officer, even with a low level of indebtedness, would have a negative cash flow during a simulated 5-year residency.

In their evaluation of the implications of study findings, the authors explore the short- and long-term effects of the negative cash flow findings:

> "In the short term, this negative cash flow and accumulating deficit has effects on a residents' value system, outlook on his or her training, attentiveness to clinical responsibilities, receptiveness to teaching, and ultimately on his or her overall professional education and residency performance. Further, it encourages (and at higher levels, likely mandates) the resident to participate in available extracurricular, remunerative activities In the long run, the need to accentuate financial remuneration at the expense of other factors in practice selection (rural vs urban location, working in medically underserved areas or with the medically indigent, health maintenance organization employment vs private practice, attractiveness of academic careers or primary care specialities) has obvious effects on trends in health care manpower allocation and medical economics by promoting physician specialization, high professional fees, practice in urban environments, and practice in affluent populations."

In addition to these broader issues, the JAMA study findings seriously challenge the wisdom of relying on forebearance as the solution to the indebtedness problem. Since interest accrues during forebearance and repayment periods are not extended beyond the established payment period, one faces the question of whether residents and young practitioners will be able to meet their loan obligations.

Entry into the Profession and Patient Care Concerns

The College is increasingly concerned that the cost of medical education is a

deterrent for highly qualified students to choose the profession of medicine. We strongly believe that socioeconomic status should not be a barrier to any qualified medical student candidate and that the profession benefits greatly by representation of individuals from different backgrounds. But even the most motivated student would find an average debt of $42,000 daunting, especially to minority students whose debt is on average $5,000 greater.

The decline in the number of applicants to medical school over the past decade gives pause for concern. In Canada where the average tuition is less than $2,000 a year, compared to a median cost of $17,454 for private schools and $5,849 for public schools in the U.S., there is an average of four applicants for each first year opening in medical schools, compared to the U.S. average of 1.6. The cost of medical education may be a deterrent for choosing medicine in the first place and deferment period of only two years may be an additional and unneeded disincentive.

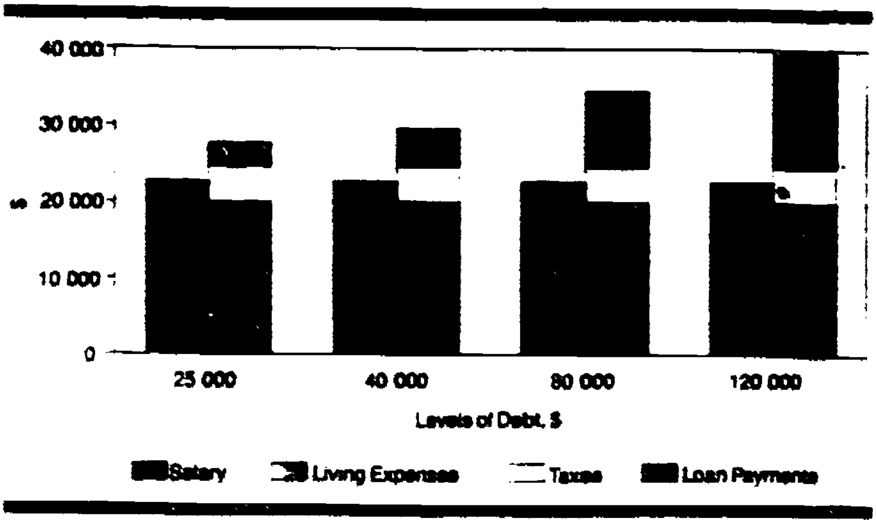
The impact of indebtedness on specialty choice and practice location needs additional study. Current research indicates that other factors such as lifestyle and patient characteristics have a greater influence on these choices than debt or income. In a time of great need for additional primary care physicians, ACP urges the undertaking of additional research on the factors that influence speciality choice.

Our final comments address the implications of the two-year deferment period on patient care. Data from the AAMC's survey of third year residents indicates that

75 percent of residents said that they would be unable to discharge their debts if their incomes were limited to housestaff incomes only. Three-quarters felt that they had to seek outside employment to meet their financial obligations and two thirds indicated that they were currently moonlighting. At a time when there is a growing consensus that residency hours should be limited in the interest of good patient care, we urge the Congress to examine whether a deferment period that ends before the residency is sound public policy.

Conclusion

The issue of loan deferment for medical residents may seem relatively inconsequential in the context of the far-reaching implications of the Higher Education Act reauthorization, but the decisions made by the Congress on this matter will have a serious impact both on individual residents and the medical profession. We are very aware that tight fiscal constraints make these decisions especially difficult. It is our view that H.R. 179 will reduce loan defaults, lessen the need to moonlight and therefore improve patient care, and contribute to keeping the medical profession open to individuals from all socioeconomic groups.



Paying for medical school—the effect of debt on first-year residents. Assumes 9% fixed interest rate repaid over 15 years.

NBD Bank Evanston, N.A.
Orrington at Davis
Evanston, Illinois 60204-0552
Phone 708-491-6000

John W. Taylor III
Chairman of the Board

June 27, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Dear Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

1. _Issue_: 8%/10% Stafford interest rate and associated windfall profits provision

Comments: The 8%/10% rate and, especially, the windfall profits provision, are both difficult to administer and difficult for borrowers to understand. I suggest:

* Eliminate the 8%/10% Stafford and windfall profits provision.
* Replace it with a new variable rate Stafford with an 8% floor and a 12% cap, based on the same Treasury Bill rate used currently for SLS and PLUS loans.
* Convert all existing 8%/10% loans to fixed rate 8% loans.

This would minimize government interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% program. It would also minimize administrative error by lenders since we, and most others, already have variable rate programs we administer. (We do not have any windfall profits programs.)

The Honorable William D. Ford
June 27, 1991
Page Two

2. Issue: Risk Sharing

Comments: Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:

* Limit student access, as lenders will minimize their high risk/low balance loan portfolio proportionately.

* Result in diminished support to students attending moderate- to high-default schools, directly proportional to the stringency of the risk sharing requirements.

I continue to be required to meet performance standards set by my institution. High-cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. Issue: Special Allowance Payments (SAP)

Comments: SAP should remain unchanged.

* Any reduction in SAP will decrease further the number of participating lenders, thus adversely affecting access to student loans.

* A change in computing SAP, if applied the first quarter of a calendar year to a 365-day basis, could save the Federal Government money (on a one-time basis).

4. Issue: Simplification of Financial Aid

Comments: The financial aid process and administration continue to be very complex for students, parents, schools, and lenders. I recommend simplification in the following areas:

The Honorable William D. Ford
June 27, 1991
Page Three

* Use only one need analysis calculation for all Title IV programs.

* Make Stafford loans available to middle-income students.

* Reduce the number of deferments for all GSL programs to:

  1) in-school; for full-time students and degree-seeking students attending at least half time but less than full time and making satisfactory progress

  2) unemployment

  3) total temporary disability

  4) military; including acceptance of other documentation (e.g., orders) as certification

* Expand acceptable reasons (documentation, notification, and certification) for granting deferments (e.g., Student Status Confirmation Reports, school letter, loan application, etc.).

* Allow backdating of in-school deferments to the start of a school term but not more than 180 days.

5. Issue: Flexibility in Collection Efforts

Comments: I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:

* Define new measures that allow use of our collections expertise.

* Define new measures that are flexible.

* Allow cures for actions missed inadvertently.

The Honorable William D. Ford
June 27, 1991
Page Four

6. Issue: Timely Regulations

Comments: I recommend the following:

* Require regulations to be created through a negotiated rulemaking process.

* Require regulations to be issued in a timely manner that allows for proper system changes (including testing) and staff training.

I am sure you understand my concern surrounding rumors of a direct loan program to replace the current Stafford program. While I have seen no proposal to comment on specifically, I feel the comments and suggestions I have made address many of the same issues that a direct loan program would intend to address, such as reduced costs and program simplification. Should a specific proposal be put forth, I trust you will solicit input and suggestions from the lending community. I commit to providing input on such a proposal.

Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

John W. Taylor, III

JWT/ple

CC: The Honorable Paul Simon
The Honorable Alan J. Dixon
The Honorable Sidney R. Yates

UNIVERSITY NATIONAL BANK

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

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UNIVERSITY NATIONAL BANK

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Kenneth R. Sticken
Vice President

KRS/mjz

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South Holland Bank

South Holland Trust & Savings Bank 16178 South Park Avenue South Holland, Illinois 60473-1524 (708) 333-2600 FAX (708) 333-3091

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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Established 1911

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Louise Erickson

Louise Erickson
Student Loan Coordinator

cc: Paul Simon

LaSalle Bank Lake View

ABN AMRO LASALLE

3201 North Ashland Avenue
Chicago, Illinois 60657
(312) 525-2180

Frank L. Dwojecki
Vice President and Manager

June 27, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

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LaSalle Bank Lake View

ABN·O·LASALLE

-2-

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I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

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LaSalle Bank Lake View

ABN·O·LASALLE

-3-

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Sincerely,

Frank L. Dwojacki
Vice President
Installment Loan Department

Copy: Jock MacMorran

AMERICAN NATIONAL BANK

3307 CHICAGO ROAD • SOUTH CHICAGO HEIGHTS ILLINOIS 60411 • PHONE 708 756 2815 • FAX 708 756 1252
1056 DIXIE HIGHWAY • CRETE ILLINOIS 60417 • PHONE 708 672 7000 • FAX 708 672 7002
19201 LAGRANGE ROAD • MOKENA ILLINOIS 60448 • PHONE 708 479 4490 • FAX 708 479 4495

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

James Esposito

James Esposito
President

cc: Honorable Paul Simon

Herget National Bank

June 25, 1991

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United States House of Representatives
Washington, D.C. 20515-2215

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33 S Fourth St • Pekin, Illinois 61554 • (309) 347-1131

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Melody A. Lower

Melody A. Lower
Student Loan Officer

cc: The Honorable Paul Simon
United States Senate
Washington, D.C. 20510-1302

cc: The Honorable Robert H. Michel
House of Representatives
2112 Rayburn House Office Building
Washington, D.C. 20515-2215

MAL:jd

Household Bank

Student Loan Center
1400 North Gannon Drive
Hoffman Estates IL 60194
(708) 885 1005

June 25, 1991

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United States House of Representatives
Washington, D.C. 20515-2215

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[illegible]
[illegible] Manager

MIDWEST BANK
And Trust Company

MIDWEST BANK AND TRUST COMPANY

FIRST MIDWEST CORPORATION OF DELAWARE

MIDWEST BANK OF UNION

MIDWEST BANK OF HINSDALE

June 21, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

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Sincerely,

Stephen C. Conti
Assistant Vice President

cc: Honorable Paul Simon, United States Senate, Washington, D.C. 20510-1302

Bank of Buffalo Grove
40 EAST DUNDEE ROAD
BUFFALO GROVE, ILLINOIS 60089
AREA CODE 312 537-3900

DAVID H CURTIS
PRESIDENT

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

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Sincerely,

David H. Curtis
President

cc: Congressman John Porter
Senator Paul Simon

ORLAND State Bank

9612 W 143rd STREET • ORLAND PARK IL 60462 0439
(708) 349 8500

June 25, 1991

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Washington, D.C. 20515-2215

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   This would minimize government interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% program. It would also minimize administrative error by lenders since we, and most others, already have variable rate programs we administer. (We do not have any windfall profit programs.)

2. <u>Issue:</u> Risk Sharing
   <u>Comments:</u> Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
   - Limit student access as lenders will minimize their high risk/low balance loan portfolio proportionately.

ORLAND STATE BANK
9612 W. 143rd St.
Orland Park, IL 60462

page 2

- Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. Issue: Special Allowance Payments (SAP)
   Comments: SAP should remain unchanged.
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   - A change in computing SAP, if applied the first quarter of a calendar year, to a 365 day basis could save the Federal Government money (on a one time basis).

4. Issue: Simplification of Financial Aid
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     1) in-school; for full time students and degree seeking students attending at least half time but less than full time and making satisfactory progress
     2) unemployment
     3) total temporary disability
     4) military; including acceptance of other documentation (e.g., orders) as certification
   - Expand acceptable reasons (documentation, notification and certification) for granting deferments. (e.g., Student Status Confirmation Reports, school letter, loan application, etc.)
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5. Issue: Flexibility in Collection Efforts
   Comments: I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:
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ORLAND STATE BANK
9612 W. 143rd St.
Orland Park, IL 60462

- Define new measures that are flexible.
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   Comments: I recommend the following:
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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

June Meter

June Meter
Student Loan Officer
Orland State Bank
708-349-8500 X 266

THE BOATMEN'S NATIONAL BANK OF ST. LOUIS

4249 Watson Road
St. Louis, Missouri 63109
314 781-4421

JUNE PARRES
Assistant Vice President
South Region

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

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THE BOATMEN'S NATIONAL BANK OF ST. LOUIS

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

June Parres
Vice President

JP/cc

cc: Honorable Paul Simon
United States Senate
Washington, D.C. 20510-1302

First of America Bank - Illinois, N.A.
301 S.W. Adams Street
Peoria, Illinois 61652-0749
Telephone 309 655 5000

FIRST OF AMERICA

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

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First of America Bank - Illinois, N.A.
301 S.W. Adams Street
Peoria, Illinois 61652-0749
Telephone 309 655 5000

FIRST OF AMERICA

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I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

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First of America Bank - Illinois, N.A.
301 S.W. Adams Street
Peoria, Illinois 61652-0749
Telephone 309 655 5000

FIRST OF AMERICA

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- Allow cures for actions missed inadvertently.

6. **Issue:** Timely Regulations
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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Mona Thurman

Mona Thurman
Student Loan Representative
First of America Bank - Illinois, N.A

CC: Honorable Paul Simon

FIRST NATIONAL BANK OF MORTON GROVE

6201 DEMPSTER STREET • MORTON GROVE, ILLINOIS 60053
TELEPHONE (312) 965-4400

June 24, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

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   Comments: The 8%/10% rate and, especially, the windfall profits provision, are both difficult to administer and difficult for borrowers to understand. I suggest:
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   - Convert all existing 8%/10% loans to fixed rate 8% loans.
   - Replace it with a new variable rate Stafford with an 8% floor and 12% cap, based on the same Treasury Bill rate used currently for SLS and PLUS loans.

   This would minimize government interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% program. It would also minimize administrative error by lenders.

2. Issue: Risk Sharing
   Comments: Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
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I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. Issue: Special Allowance Payments (SAP)
   Comments: SAP should remain unchanged.
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Page 3

I am sure you understand my concern surrounding rumors of a direct loan program to replace the current Stafford program. While I have seen no proposal to comment on specifically, I feel the comments and suggestions I have made address many of the same issues a direct loan program would intend to address, such as reduced costs and program simplification. Should a specific proposal be put forth, I trust you will solicit input and suggestions from the lending community. I commit to providing input on such a proposal.

Thank you for your consideration and for your commitment to such an important piece of legislation.

Very truly yours,

Joellen J. Davis
Student Loan Administrator

SOUTH CHICAGO BANK
9200 Commercial Avenue
Chicago Illinois 60617
Telephone: (312) 768-1400

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

We would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what we would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to South Chicago Bank. As you consider changes and improvements to the Programs, please note the concerns and suggestions we have listed.

1. Issue: 8%/10% Stafford interest rate and associate windfall profit provision
   Comments: The 8%/10% rate and ,especially, the windfall profits provision, are both difficult to administer and difficult for borrowers to understand. We suggest:
   - Eliminate the 8%/10% Stafford and windfall profits provision.
   - Replace it with a new variable rate Stafford with an 8% floor and 12 % cap, based on the same Treasury Bill rate used currently for SLS and Plus loans.
   - Convert all existing 8%/10% loans to fixed rate 8% loans.

This would minimize government interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% program. It would also minimize administrative error by lenders since we, and most others, already have variable rate programs we administer. (We do not have any windfall profit programs.)

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Established 1902
A Commercial Bank and Trust Company - A Subsidiary of Advance Bancorp, Inc

- Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

We continue to be required to meet performance standards set by South Chicago Bank. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require:

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

SOUTH CHICAGO BANK
Jack Lester
Vice-President

cc: The Honorable Paul Simon
The Honorable Gus Savage

Uptown National Bank
of Chicago
4753 North Broadway
Chicago Illinois 60640
312/878-2000

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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Uptown National Bank
of Chicago
4753 North Broadway
Chicago Illinois 60640
312/878-2000

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Uptown National Bank
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312 878 2000

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Brad L. Rossi
Manager, Loans Operations

BLR/ow

First Bankers Trust Company, N.A.
Student Loan Department
3333 Broadway
Quincy IL 62301

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

James R Obert
Student Loan Officer

Firstar DuPage Bank

FIRSTAR

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

1. Issue: 8%/10% Stafford interest rate and associated windfall profit provision
   Comments: The 8%/10% rate and, especially, the windfall profits provision, are both difficult to administer and difficult for borrowers to understand. I suggest:
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I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. Issue: Special Allowance Payments (SAP)
   Comments: SAP should remain unchanged.
   - Any reduction in SAP will decrease further the number of participating lenders thus adversely affecting access to student loans
   - A change in computing SAP, if applied the first quarter of a calendar year, to a 365 day basis could save the Federal Government money (on a one time basis).

4. Issue: Simplification of Financial Aid
   Comments: The financial aid process and administration continues to be very complex for students, parents, schools and lenders. I recommend simplification in the following areas:
   - Use only one need analysis calculation for all Title IV programs.
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   Comments: I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:
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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Joanne C. Neumann

Joanne C. Neumann
Assistant Vice President

Firstar Park Forest Bank

FIRSTAR

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Michele C. Sportiello

Michele C. Sportiello
Administrative Assistant
Student Loan Department

Champion Federal

June 25, 1991

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United States House of Representatives
Washington, D.C. 20515-2215

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Champion Federal Savings and Loan Association
Home Office 115 E. Washington St. PO Box 127 Bloomington, Illinois 61702-0127 309 829-0456

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

CHAMPION FEDERAL SAVINGS AND LOAN ASSOCIATION

Theresa M. Mickels

Theresa M. Mickels
Student Loan Manager

tmm

cc: Senator Paul Simon

TheBANK of Edwardsville

June 27, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Dear Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

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MAIN OFFICE
330 West Vandalia
Edwardsville, IL 62025
618/656-0057

MONTCLAIRE CENTER
300 Montclaire Avenue
Edwardsville, IL 62025
618/656-0057

COLLINSVILLE CENTER
101 South Morrison
Collinsville, IL 62234
618/344-6100

TROY CENTER
120 West Market
Troy, IL 62294
618/667-6702

2. Issue: Risk Sharing
Comments: Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
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Yours very truly,

Patti J. Ambuel

Patti J. Ambuel
Student Loan Administrator

PJA/sb

cc: Illinois United States House of Represenatives Jerry F. Costello

cc: United States Senate The Honorable Paul Simon

First Midwest

First Midwest Bank
50 West Jefferson Street
Joliet, Illinois 60431-1399
(815) 727-5222

June 24, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Judy Veronda

Judy Veronda
Student Loan Coordinator

MARINE BANK

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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The Honorable William D. Ford
June 25, 1991
Page Two

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The Honorable William D. Ford
June 25, 1991
Page Three

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

M. Gary Jacobs
Student Loan Officer

MGJ:km
8719C

June 28, 1991

First Financial Bank

The Honorable William D. Ford
U.S. House of Representatives
Washington, D.C. 20515-2215

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FIRST FINANCIAL BANK, FSB
1305 MAIN STREET
STEVENS POINT, WISCONSIN 54481
(715) 341-0400

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

James T. Ford
Senior Vice President

JTF:sad

Gary-Wheaton Bank
FIRST CHICAGO

June 28, 1991

The Honorable William D. Ford
United States House of Respresentatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommitte on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

1. Issue: 8%/10% Stafford interest rate and associated windfall profit provision
   Comments: The 8%/10% rate and, especially, the windfall profits provision, are both difficult to administer and difficult for borrowers to understand. I suggest:
   - Eliminate the 8%/10% Stafford and windfall profits provision.
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   Comments: Rish sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
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[illegible]
[illegible]

I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. Issue: Special Allowance Payments (SAP)
   Comments: SAP should remain unchanged.
   - Any reduction in SAP will decrease further the number of participating lenders thus adversely affecting access to student loans.
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   Comments: The fianancial aid process and administration schools and lenders. I recommend simplification in the following areas:
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     4) military; including acceptance of other documentation (e.g., orders) as certification
   - Expand acceptable reasons (documentation, notification and certification) for granting deferments. (e.g., Student Status Confirmation Reports, school letter, loan application, etc.)
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   Comments: I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:
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I am sure understand my concern surrounding rumors of a direct loan program to replace the current Stafford program. While I have seen no proposal to comment on specifically, I feel the comments and suggestions I have made address many of the same issues direct loan program would intend to address, such as reduced costs and program simplification. Should a specific proposal be put be put forth, I trust you will solicit input and suggestions from the lending community. I commit to providing input on such a proposal.

Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Colin E. Berry

cc: Senator Paul Simon

Gary-Wheaton Bank
FIRST CHICAGO

June 28, 1991

The Honorable William D. Ford
United States House of Respresentatives
Washington, D.C. 20515-2215

Congressman Ford:

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Janice M. Carlson

cc: Senator Paul Simon

Gary-Wheaton Bank
FIRST CHICAGO

June 28, 1991

The Honorable William D. Ford
United States House of Respresentatives
Washington, D.C. 20515-2215

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

cc: Senator Paul Simon

Northern Trust Bank/O'Hare

8501 West Higgins Road, Chicago, Illinois 60631-2882
(312) 693-5555

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

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   - Convert all existing 8%/10% loans to fixed rate 8% loans.

This would minimize government interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% program. It would also minimize administrative error by lenders since we, and most others, already have variable rate programs we administer. (We do not have any windfall profit programs.)

2. Issue: Risk Sharing
   Comments: Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
   - Limit student access as lenders will minimize their high risk/low balance loan portfolio proportionately.

- Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. <u>Issue:</u> Special Allowance Payments (SAP)
   <u>Comments:</u> SAP should remain unchanged.
   - Any reduction in SAP will decrease further the number of participating lenders thus adversely affecting access to student loans
   - A change in computing SAP, if applied the first quarter of a calendar year, to a 365 day basis could save the Federal Government money (on a one time basis).

4. <u>Issue:</u> Simplification of Financial Aid
   <u>Comments:</u> The financial aid process and administration continues to be very complex for students, parents, schools and lenders. I recommend simplification in the following areas:
   - Use only one need analysis calculation for all Title IV programs.
   - Make Stafford loans available to middle income students.
   - Reduce the number of deferments for all GSL programs to:
     1) in-school; for full time students and degree seeking students attending at least half time but less than full time and making satisfactory progress
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     4) military; including acceptance of other documentation (e.g., orders) as certification
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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Raquel Morales

Raquel Morales
Second Vice President
Student Loan Officer
(312) 714-6306

River Forest Bank

Student Loan Processing Center

P.O. Box [illegible]
Chicago, IL [illegible]
(312) [illegible]
(800) [illegible]

June 27, 1991

The Hororable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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   * Replace it with a new variable rate subsidized Stafford with an 8% floor and 12% cap, based on the same Treasury Bill rate used currently for SLS and PLUS loans.
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River Forest State Bank and Trust Company
Member FDIC

The Horable William D. Ford
June 27, 1991
Page -2-

the due diligence procedures currently required for the collection for student loans. Additional risk sharing would:

* Limit student access as lenders will minimize their high risk/low balance loan portfolio proportionately.
* Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. Issue: Special Allowance Payments (SAP)
Comments: SAP should remain unchanged.
   * Any reduction in SAP will decrease further the number of participating lenders thus adversely affecting access to student loans
   * Change the computation of SAP from a 360 day year to a 365 day year. This would save the federal Government money (on a one time basis) and make ED Form 799 more consistant.

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Comments: The financial aid process and administration continues to be very complex for students, parents, schools and lenders. I recommend simplification in the following areas:
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The Horable William D. Ford
June 27, 1991
Page -3-

- Allow backdating of in-school deferments to the start of a school term but not more than 180 days.

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Peter Lantero
Vice President
River Forest Bank

OLD KENT BANK

[illegible] South York Street
Elmhurst, Illinois [illegible]

The Chancellory
500 Park Boulevard
Suite [illegible]
Itasca, Illinois [illegible]

[illegible] South Bluff [illegible] Road
Wheaton, Illinois [illegible]

[illegible] North Main Street
Wheaton, Illinois [illegible]

[illegible] Bichert Drive
Naperville, Illinois [illegible]

[illegible] Park Avenue
Clarendon Hills, Illinois [illegible]

[illegible] South Cass Avenue
Westmont, Illinois [illegible]

[illegible] & County Farm Roads
Winfield, Illinois [illegible]

[illegible] West Main Street
St. Charles, Illinois [illegible]

[illegible] North Randall Road
St. Charles, Illinois [illegible]

[illegible] Algonquin Road
Rolling Meadows, Illinois [illegible]

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D. C. 20515-2215

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OLD KENT BANK N.A.

[illegible] South York Street
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(708) [illegible]

The Chancellory
[illegible] Park Boulevard
Suite [illegible]
Itasca, Illinois [illegible]
(708) [illegible]

[illegible] South Blanchard Road
Wheaton, Illinois [illegible]
(708) [illegible]

[illegible] North Main Street
Wheaton, Illinois [illegible]
(708) [illegible]

1296 Richert Drive
Naperville, Illinois [illegible]
(708) [illegible]

[illegible] Park Avenue
Clarendon Hills, Illinois [illegible]
(708) [illegible]

[illegible] South Cass Avenue
Westmont, Illinois [illegible]
(708) [illegible]

Geneva & County Farm Roads
Winfield, Illinois [illegible]
(708) [illegible]

[illegible] West Main Street
St. Charles, Illinois [illegible]
(708) [illegible]

[illegible] North Randall Road
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(708) [illegible]

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OLD KENT BANK N.A.

[illegible] South York Street
Elmhurst, Illinois 60126
(708) [illegible]

The Chancellory
500 Park Boulevard
Suite 185
Itasca, Illinois 60143
(708) [illegible]

[illegible] South Blanchard Road
Wheaton, Illinois 6018[illegible]
(708) [illegible]

1500 North Main Street
Wheaton, Illinois 6018[illegible]
(708) [illegible]

1256 Rickert Drive
Naperville, Illinois [illegible]
(708) [illegible]

200 Park Avenue
Clarendon Hills, Illinois [illegible]
(708) 920-[illegible]

[illegible] South Cass Avenue
Westmont, Illinois [illegible]
(708) 920-[illegible]

Geneva & County Farm Roads
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(708) [illegible]

300 West Main Street
St. Charles, Illinois [illegible]
(708) [illegible]

[illegible] North Randall Road
St. Charles, Illinois [illegible]
(708) [illegible]

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Rolling Meadows, Illinois [illegible]
(708) [illegible]

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Carol Brown

Carol Brown
Student Loan Officer

cc: Paul Simon

South Shore Bank

71st and Jeffery Boulevard
Chicago Illinois 60649 2096
312 288 1000

A Shorebank Company

June 26, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D. C. 20515-2215

Dear Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, to be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

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   - Replace it with a new variable rate Stafford with an 8% floor and 12% cap, based on the same Treasury Bill rate used currently for SLS and PLUS loans.
   - Convert all existing 8%/10% loans to fixed rate 8% loans.

This would minimize goverment interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% program. It would also minimize administrative error by lenders since we, and most others, already have variable rate programs we administer. (We do not have any windfall profit programs.)

2. Issue: Risk Sharing
   Comments: Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:

   - Limit student access as lenders will minimize their high

risk/low balance loan portfolio proportionately.

- Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. Issue: Special Allowance Payments (SAP)
Comments: SAP should remain unchanged.

- Any reduction in SAP will decrease further the number of participating lenders thus adversely affecting access to student loans
- A change in computing SAP, if applied the first quarter of a calendar year, to a 365 day basis could save the Federal Goverment money (on a one time basis).

4. Issue: Simplification of Financial Aid
Comments: The financial aid process and administration continues to be very complex for students, parents, schools and lenders. I recommend simplification in the following areas:

- Use only one need analysis calculation for all Title IV programs.
- Make Stafford loans available to middle income students.
- Reduce the number of deferments for all GSL programs to:
  1) in-school; for full-time students and degree seeking students attending at lease half-time, but less than full-time and making satisfactory progress.
  2) unemployment
  3) total temporary disability
  4) military; including acceptance of other documentation (e.g., orders) as certification
- Expand acceptable reasons (documentation, notification and certification) for granting deferments. (e.g., Student Status Confirmation Reports, school letter, loan application, etc.)
- Allow backdating of in-school deferments to the start of a school term but not more than 180 days.

5. Issue: Flexibility in Collection Efforts
Comments: I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:

- Define new measures that allow use of our collections expertise.
- Define new measures that are flexible

- Allow cures for actions missed inadvertently.

6. Issue: Timely Regulations
   Comments: I recommend the following:

   - Require regulations to be created through a negotiated rulemaking process.
   - Require regulations to be issued in a timely manner that allows for proper system changes (including testing) and staff training.

I am sure you understand my concern surrounding rumors of a direct loan program to replace the current Stafford program. While I have seen no proposal to comment on specifically, I feel the comments and suggestions I have made address many of the same issues a direct loan program would intend to address, such as reduced costs and program simplification. Should a specific proposal be put forth, I trust you will solicit input and suggestions from the lending community. I commit to providing input on such a proposal.

Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

SOUTH SHORE BANK OF CHICAGO

James Fletcher,
President

Cole Taylor Bank
[illegible]
[illegible]
[illegible]

COLE TAYLOR BANK

June 27, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

1. Issue: 8%/10% Stafford interest rate and associated windfall profit provision
   Comments: The 8%/10% rate and, especially, the windfall profits provision, are both difficult to administer and difficult for borrowers to understand. I suggest:
   * Eliminate the 8%/10% Stafford and Windfall profits provision.
   * Replace it with a new variable rate Stafford with an 8% floor and 12% cap, based on the same Treasury Bill rate used currently for SLS and PLUS loans.
   * Convert all existing 8%/10% loans to fixed rate 8% loans.

   This would minimize government interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% program. It would also minimize administrative error by lenders since we, and most others, already have variable rate programs we administer. (We do not have any windfall profit programs.)

2. Issue: Risk Sharing
   Comments: Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
   * Limit student access as lenders will minimize their high risk/low balance loan portfolio proportionately.

Member FDIC

47-282 0 - 91 - 7

The Honorable William D. Ford
June 27, 1991
Page 2

* Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

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The Honorable William D. Ford
June 27, 1991
Page 3

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Regina Broadnax

Regina Broadnax
Student Loan Department

RB/jy

cc: Honorable Paul Simon
    U.S. Senate

Central Bank
3303 Nameoki Road Granite City Illinois 62040 451 6600

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

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     2) unemployment
     3) total temporary disability
     4) military; including acceptance of other documentation (e.g., orders) as certification
   - Expand acceptable reasons (documentation, notification and certification) for granting deferments. (e.g., Student Status Confirmation Reports, school letter, loan application, etc.)
   - Allow backdating of in-school deferments to the start of a school term but not more than 180 days.

5. Issue: Flexibility in Collection Efforts
Comments: I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:
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- Define new measures that are flexible.
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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

K. A. Frank
Senior Vice President

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

1. Issue: 8%/10% Stafford interest rate and associated windfall profit provision
   Comments: The 8%/10% rate and, especially, the windfall profits provision, are both difficult to administer and difficult for borrowers to understand. I suggest:
   - Eliminate the 8%/10% Stafford and windfall profits provision.

2. Issue: Risk Sharing
   Comments: Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
   - Limit student access as lenders will minimize their high risk/low balance loan portfolio proportionately.

- Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. Issue: Special Allowance Payments (SAP)
   Comments: SAP should remain unchanged.
   - Any reduction in SAP will decrease further the number of participating lenders thus adversely affecting access to student loans
   - A change in computing SAP, if applied the first quarter of a calendar year, to a 365 day basis could save the Federal Government money (on a one time basis).

4. Issue: Simplification of Financial Aid
   Comments: The financial aid process and administration continues to be very complex for students, parents, schools and lenders. I recommend simplification in the following areas:
   - Use only one need analysis calculation for all Title IV programs.
   - Make Stafford loans available to middle income students.
   - Reduce the number of deferments for all GSL programs to:
     1) in-school; for full time students and degree seeking students attending at least half time but less than full time and making satisfactory progress
     2) unemployment
     3) total temporary disability
     4) military; including acceptance of other documentation (e.g., orders) as certification
   - Expand acceptable reasons (documentation, notification and certification) for granting deferments. (e.g., Student Status Confirmation Reports, school letter, loan application, etc.)
   - Allow backdating of in-school deferments to the start of a school term but not more than 180 days.

5. Issue: Flexibility in Collection Efforts
   Comments: I am very concerned about the present due diligence requirements.

- Allow cures for actions missed inadvertently.

6. Issue: Timely Regulations
   Comments: I recommend the following:
   - Require regulations to be created through a negotiated rulemaking process.
   - Require regulations to be issued in a timely manner that allows for proper system changes (including testing) and staff training.

I am sure you understand my concern surrounding rumors of a direct loan program to replace the current Stafford program. While I have seen no proposal to comment on specifically, I feel the comments and suggestions I have made address many of the same issues a direct loan program would intend to address, such as reduced costs and program simplification. Should a specific proposal be put forth, I trust you will solicit input and suggestions from the lending community. I commit to providing input on such a proposal.

Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Laurie Severs

LAURIE SEVERS
STUDENT LOAN COORDINATOR
I.H. MISSISSIPPI VALLEY C.U.
17 AVE & KENNEDY DR.
EAST MOLINE, IL 61244
309-797-7210

Palos Bank and Trust

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to submit the following comments, concerning reauthorization of the Higher Education Act of 1965, to be accepted and entered as part of the record associated with the June 18, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the comments and suggestions I have listed.

1. <u>Issue:</u> 8%/10% Stafford interest rate and associated windfall profit provision
   <u>Comments:</u> The 8%/10% rate and, especially, the windfall profit provision, are both difficult to administer and difficult for borrowers to understand. I suggest:
   - Eliminate the 8%/10% Stafford and windfall profit provision.
   - Replace it with a new variable rate Stafford with an 8% floor and 12% cap, based on the same Treasury bill rate used currently for SLS and PLUS loans.
   - Convert all existing 8%/10% loans to fixed rate 8% loans.

   This would minimize government interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% program. It would also minimize administrative error by lenders since we, and most others, already have variable rate programs we administer. (We do not have any windfall profit programs.)

2. <u>Issue:</u> Risk Sharing
   <u>Comments:</u> Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
   - Limit student access as lenders will minimize their high risk/low balance loan portfolio proportionately.

Main Bank: 12600 South Harlem Avenue / North Bank: 124th & Harlem / Palos Heights, Illinois 60463 / Phone: (708) 448 9100
Palos Bank and Trust Company / Member FDIC

- Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. <u>Issue:</u> Special Allowance Payments (SAP)
   <u>Comments:</u> SAP should remain unchanged.
   - Any reduction in SAP will decrease further the number of participating lenders thus adversely affecting access to student loans
   - A change in computing SAP, if applied the first quarter of a calendar year, to a 365 day basis could save the Federal Government money (on a one time basis).

4. <u>Issue:</u> Simplification of Financial Aid
   <u>Comments:</u> The financial aid process and administration continues to be very complex for students, parents, schools and lenders. I recommend simplification in the following areas:
   - Use only one need analysis calculation for all Title IV programs.
     Make Stafford loans available to middle income students.
   - Reduce the number of deferments for all GSL programs to:
     1) in-school: for full time students and degree seeking students attending at least half time but less than full time and making satisfactory progress
     2) unemployment
     3) total temporary disability
     4) military; including acceptance of other documentation (e.g., orders) as certification
   - Expand acceptable reasons (documentation, notification and certification) for granting deferments. (e.g., Student Status Confirmation Reports, school letter, loan application, etc.)
   - Allow backdating of in-school deferments to the start of a school term but not more than 180 days.

5. <u>Issue:</u> Flexibility in Collection Efforts
   <u>Comments:</u> I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:
   - Define new measures that allow use of our collections expertise.

- Define new measures that are flexible.
- Allow cures for actions missed inadvertently.

6. <u>Issue:</u> Timely Regulations
   <u>Comments:</u> I recommend the following:
   - Require regulations to be created through a negotiated rulemaking process.
   - Require regulations to be issued in a timely manner that allows for proper system changes (including testing) and staff training.

I am sure you understand my concern surrounding rumors of a direct loan program to replace the current Stafford program. While I have seen no proposal to comment on specifically, I feel the comments and suggestions I have made address many of the same issues a direct loan program would intend to address, such as reduced costs and program simplification. Should a specific proposal be put forth, I trust you will solicit input and suggestions from the lending community. I commit to providing input on such a proposal.

Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

[illegible] TRUST COMPANY

Thomas [illegible]

Thomas J. [illegible]
Assistant Vice President

Heritage Glenwood Bank

183rd & Halsted Streets, Glenwood IL 60425
(708) 755-3800

91st Ave & 159th Street, Orland Hills, IL 60477
(708) 403-0001

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

1. <u>Issue:</u> 8/10% Stafford interest rate and associated windfall profit provision
   <u>Comments:</u> The 8/10% rate and the windfall profit provision are both difficult to administer and difficult for borrowers to understand. I suggest:

   - Eliminate the 8/10% Stafford and windfall profits provision.
   - Replace it with a new variable rate Stafford with an 8% floor and 12% cap, based on the same Treasury Bill rate used currently for SLS and PLUS loans.
   - Convert all existing 8/10% loans to fixed rate 8% loans.
   - If not eliminating 8/10%, allow deferments to bump the 8% rate for the same length of the deferment.

   This would minimize government interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% Program. It would also minimize administrative error by lenders since we, and most others, already have variable rate programs we administer (We do not have any windfall profit programs.)

2. <u>Issue:</u> Risk Sharing
   <u>Comments:</u> Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:

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3. **Issue:** Special Allowance Payments (SAP)
   Comments: SAP should remain unchanged.
   - Any reduction in SAP will decrease further the number of participating lenders thus adversely affecting access to student loans.
   - A change in computing SAP, if applied the first quarter of a calendar year, to a 365 day basis could save the Federal Government money (on a one time basis).

4. **Issue:** Simplification of Financial Aid
   Comments: The financial aid process and administration continues to be very complex for students, parents, schools, and lenders. I recommend simplification in the following areas:
   - Use only one need analysis calculation for all Title IV programs.
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     4) Military; including acceptance of other documentation (e.g. orders) as certification
     5) Internship/Residency; however, if keeping, extend time limitation to longer than 2 years, as most internship residencies exceed this time.
   - Expand acceptable reasons (documentation, notification and certification) for granting deferments (e.g. Student Status Confirmation Reports, school letter, loan application, etc.)
   - Allow backdating of in-school deferments to the start of a school term but not more than 180 days.

5. __Issue:__ Flexibility in Collection Efforts
__Comments:__ I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Mary Lou Ruiz

Mary Lou Ruiz
Student Loan Manager

MLR/dts

GREAT LAKES CREDIT UNION
GREAT LAKES, IL 60088-8290
1-800-323-3160
(708)689-1510

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

GREAT LAKES CREDIT UNION

Nancy Shutz

NANCY SHUTZ
LOAN OFFICER

cc: Paul Simon
United States Senate
Washington, D.C. 20510-1302

MARQUETTE NATIONAL BANK

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

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This would minimize government interest and special allowance payments, while maintaining the concept of the borrower paying a larger portion of interest than under a flat 8% program. It would also minimize administrative error by lenders since we, and most others, already have variable rate programs we administer. (We do not have any windfall profit programs.)

2. <u>Issue:</u> Risk Sharing
   <u>Comments:</u> Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
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6316 SOUTH WESTERN AVENUE CHICAGO ILLINOIS 60636 PHONE 312 476 5100
FACILITY 6155 SOUTH PULASKI ROAD CHICAGO ILLINOIS 60629 PHONE 312 838 3100

- Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

I continue to be required to meet performance standards set by my institution. High cost borrowers will be the first to be excluded from our portfolio if new risk sharing costs so require.

3. <u>Issue:</u> Special Allowance Payments (SAP)
   <u>Comments:</u> SAP should remain unchanged.
   - Any reduction in SAP will decrease further the number of participating lenders thus adversely affecting access to student loans
   - A change in computing SAP, if applied the first quarter of a calendar year, to a 365 day basis could save the Federal Government money (on a one time basis).

4. <u>Issue:</u> Simplification of Financial Aid
   <u>Comments:</u> The financial aid process and administration continues to be very complex for students, parents, schools and lenders. I recommend simplification in the following areas:
   - Use only one need analysis calculation for all Title IV programs.
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   - Reduce the number of deferments for all GSL programs to:
     1) in-school; for full time students and degree seeking students attending at least half time but less than full time and making satisfactory progress
     2) unemployment
     3) total temporary disability
     4) military; including acceptance of other documentation (e.g., orders) as certification
   - Expand acceptable reasons (documentation, notification and certification) for granting deferments. (e.g., Student Status Confirmation Reports, school letter, loan application, etc.)
   - Allow backdating of in-school deferments to the start of a school term but not more than 180 days.

5. <u>Issue:</u> Flexibility in Collection Efforts
   <u>Comments:</u> I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:
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6. Issue: Timely Regulations
   Comments: I recommend the following:
   - Require regulations to be created through a negotiated rulemaking process.
   - Require regulations to be issued in a timely manner that allows for proper system changes (including testing) and staff training.

I am sure you understand my concern surrounding rumors of a direct loan program to replace the current Stafford program. While I have seen no proposal to comment on specifically, I feel the comments and suggestions I have made address many of the same issues a direct loan program would intend to address, such as reduced costs and program simplification. Should a specific proposal be put forth, I trust you will solicit input and suggestions from the lending community. I commit to providing input on such a proposal.

Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Carol Majdecki
Student Loan Representative

cc Mr. Paul Simon

[illegible]
President & Chief Executive Officer

First of America Bank - Rockford, N.A.
Downtown Financial Plaza
120 West State Street
P.O. Box 1628
Rockford, Illinois 61110-0128
Telephone 815-987-2046

June 25, 1991

FIRST OF AMERICA.

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Dear Congressman Ford:

I would like to request the following comments, concerning reauthorization of the Higher Education Act of 1965, be accepted and entered as part of the record associated with the June 19, 1991 hearing on the Stafford Student Loan Program held by the House Subcommittee on Postsecondary Education.

The comments that follow address what I would currently consider to be the major Guaranteed Student Loan (GSL) issues of concern to my institution. As you consider changes and improvements to the Programs, please note the concerns and suggestions I have listed.

1. <u>Issue</u>: 8%/10% Stafford interest rate and associated windfall profit provision.

   <u>Comments</u>: The 8%/10% rate and, especially, the windfall profits provision, are both difficult to administer and difficult for borrowers to understand. I suggest:

   - Eliminate the 8%/10% Stafford and windfall profits provision.

   - Replace it with a new variable rate Stafford with an 8% floor and 12% cap, based on the same Treasury Bill rate used currently for SLS and PLUS loans.

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The Honorable William D. Ford
United States House of Representatives
June 25, 1991
Page Two

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Comments: Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:

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The Honorable William D. Ford
United States House of Representatives
June 25, 1991
Page Three

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The Honorable William D. Ford
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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Alvin G. Becker
President & CEO

AGB:mas

H2-15

COMMUNITY BANK
OF GREATER PEORIA

Scenic at Sterling, Peoria, IL 61614 309•686-6100 Fax 309•686-7117

June 25, 1991

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Jill A. Callow
Loan Officer

Landmark Bank of Illinois

Fairview Heights Center
10950 Lincoln Trail
Fairview Heights, Illinois 62208
(618) 397 7200

June 25, 1991

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Patricia A. Schuster

Patricia A. Schuster
Student Loan Administrator

cc: The Honorable Paul Simon
    The Honorable Jerry Costello

NBD Bank Evanston, N.A.
Orrington at Davis
Evanston, Illinois 60204-0552
Phone 708-491-6000

June 25, 1991

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United States House of Representatives
Washington, D.C. 20515-2215

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Subsidiary of NBD Bancorp, Inc.

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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Carolyn Hsu

Carolyn Hsu
Student Loan Counselor

Harris Trust and Savings Bank
111 West Monroe Street
P.O. Box 755
Chicago Illinois 60690 0755
Telephone (312) 461 2121

HARRIS BANK

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20525-2215

Congressman Ford:

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Harris Trust and
Savings Bank

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Sonia I. Colón

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Student Loan Representative
Harris Trust and Savings Bank

First National
Bank and Trust Company

509 South University Avenue
Post Office Box 2227
Carbondale, IL 62902-2227
Phone 618-457-3381
FAX 618-529-1145

W. Craig Addison
Loan Officer

June 25, 1991

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United States House of Representatives
Washington, D.C. 20515-2215

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Sincerely,

FIRST NATIONAL BANK AND TRUST COMPANY

W. C. Addison
Loan Officer

WCA:jw

cc: The Honorable Paul Simon, United States Senate
The Honorable Glenn Poshard, United States House of Representatives

MARINE BANK

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D. C. 20515-2215

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   <u>Comments:</u> Risk sharing already exists for lenders in the due diligence procedures currently required for the collection of student loans. Additional risk sharing would:
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[illegible] BOX [illegible] CHAMPAIGN, ILLINOIS 61824
[illegible] MEMBER FDIC • FAX 217 [illegible]

MARINE BANK

. Result in diminished support to students attending moderate to high default schools, directly proportional to the stringency of the risk sharing requirements.

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Comments: SAP should remain unchanged.
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[illegible] UNIVERSITY AVENUE • P.O. BOX [illegible] • CHAMPAIGN, ILLINOIS [illegible]
[illegible] • MEMBER FDIC • FAX [illegible]

MARINE

MARINE BANK

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Comments: I recommend the following:
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Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Ronald Suits
Senior Vice President

RS/sam

[illegible] WEST UNIVERSITY AVENUE • P.O. BOX 4029 • CHAMPAIGN, ILLINOIS 61824
(217) [illegible] • MEMBER FDIC • FAX (217) 352-0084

BOATMEN'S NATIONAL BANK OF CHARLESTON

Sixth & Monroe
Charleston, Illinois 61920
217 345-2101

June 26, 1991

The Honorable William D. Ford
United States House Of Representatives
Washington, D.C. 20515-2215

Congressman Ford:

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A Subsidiary of Boatmen's Bancshares Inc

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Sincerely,

BOATMEN'S NATIONAL BANK OF CHARLESTON

Sara Jane Preston

(Mrs.) Sara Jane Preston
President

SJP:me

First National
Bank and Trust Company

509 South University Avenue
Post Office Box 2227
Carbondale, IL 62902-2227
Phone 618-457-3381
FAX 618-529-1145

W. Craig Addison
Loan Officer

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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FIRST NATIONAL BANK AND TRUST COMPANY

W. C. Addison
Loan Officer

WCA:jw

cc: The Honorable Paul Simon, United States Senate
The Honorable Glenn Poshard, United States House of Representatives

FIRST NATIONAL BANK OF BLUE ISLAND

13057 S. Western Ave. Blue Island, Illinois 60406 (708) 385-2200

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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Sincerely,

Sheila A. Berens

Sheila A. Berens
Student Loan Representative, FNBBI

SAC/sc

CC: Senator Paul Simon

The Old Second
NATIONAL BANK of AURORA

June 21, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

Congressman Simon:

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37 South River Street / Aurora, IL 60507 · 892-0202 Member FDIC

The Old Second
NATIONAL BANK of AURORA

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37 South River Street · Aurora IL 60507 · 892 0202

The Old Second
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Sincerely,

Robert G. Camp

Robert G. Camp
Vice President

37 South River Street · Aurora, Il 60507 / 892-0202 Member FDIC

Alpine Bank

ALPINE & HIGHCREST ROADS PO BOX [illegible] ROCKFORD ILLINOIS [illegible]

June 25, 1991

The Honorable William D. Ford
United States House of Representatives
Washington, D.C. 20515-2215

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Sincerely,

Sandra L. Marchione,
Assistant Vice President
Student Loan Officer

FIRST SUBURBAN NATIONAL BANK

June 25, 1991

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United States House of Representatives
Washington, D.C. 20515-2215

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12250 S. Cicero Avenue, Alsip, IL 60658-2946, (708) 385-6900
2100 W. Roosevelt Road, Broadview, IL 60153-3888, (708) 450-1207
150 S. Fifth Avenue, P.O. Box 459, Maywood, IL 60153-1388, (708) 450-4100

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   Comments: I am very concerned about the present due diligence requirements. Their prescriptive nature makes no use of the experience and expertise of our staff in loan collections. There is no incentive to concentrate on collections; only a disincentive to stray from the prescribed guidelines. I suggest:
   - Define new measures that allow use of our collections expertise.

- Define new measures that are flexible.
- Allow cures for actions missed inadvertently.

6. Issue: Timely Regulations
   Comments: I recommend the following:
   - Require regulations to be created through a negotiated rulemaking process.
   - Require regulations to be issued in a timely manner that allows for proper system changes (including testing) and staff training.

I am sure you understand my concern surrounding rumors of a direct loan program to replace the current Stafford program. While I have seen no proposal to comment on specifically, I feel the comments and suggestions I have made address many of the same issues a direct loan program would intend to address, such as reduced costs and program simplification. Should a specific proposal be put forth, I trust you will solicit input and suggestions from the lending community. I commit to providing input on such a proposal.

Thank you for your consideration and for your commitment to such an important piece of legislation.

Sincerely,

Robert P. Franch
President

United States Senate

COMMITTEE ON SMALL BUSINESS

WASHINGTON DC 20510-6350

June 18, 1991

The Honorable William D. Ford
Chairman, Subcommittee on Postsecondary Education
2451 Rayburn Building
Washington, D.C. 20515

Dear Bill:

I request that the Subcommittee print the enclosed materials in its hearing record for its hearings on the Higher Education Act Reauthorization.

I regret I was not able to appear at the June 19 hearing.

If you have any questions about my legislation or about my testimony, please have your stff contact Chuck Ludlam at x4-3095. Thank you very much for your assistance.

Sincerely,

Dale

Dale Bumpers

DB/cl

LOAN CANCELLATION FOR COMMUNITY SERVICE
TESTIMONY OF SENATOR DALE BUMPERS
BEFORE THE
SUBCOMMITTEE ON POSTSECONDARY EDUCATION
JUNE 19, 1991

Mr. Chairman and Members of the Subcommittee, I am delighted to appear here today to outline my proposal to partially cancel the Federal student loans of young persons who perform full-time service in their community upon graduation.

I will keep my statement mercifully short. I will make four points about my proposal:

1. Major Sacrifice: In order to qualify for partial cancellation of his or her loans, my proposal requires the young person to make a major sacrifice.

2. Simple Equity: My proposal extends the Peace Corps and VISTA model of full-time service into the private sector. We should provide the same incentives for comparable full-time service in the public and private sectors.

3. Encourages Service: My proposal encourages young persons to devote a year or more to full-time community service. It is not designed to change the career plans of young persons graduating from college.

4. Cost-Effective: My proposal is an extremely cost-effective way to encourage full-time community service.

Major Sacrifice

First, there is no loan cancellation proposal pending before the Subcommittee that requires more sacrifice on the part of the young person..

In order to qualify for loan cancellation under my proposal the young person --

-- must serve full time;

-- must serve with a non-profit community service organization;

-- must serve for at least one year; and

-- must not be paid more than the Federal minimum wage.

This is not a Yuppie program.

If the young person does perform this service, his or her Federal loans -- both Stafford and Perkins loans -- are cancelled according to the following schedule:

-- First year of Service -- 10% cancelled;

-- Second year of Service -- 15% cancelled;

-- Third year of Service -- 20% cancelled; and

-- Fourth year of Service -- 25% cancelled.

So, for four years of service, the young person would qualify for 70% cancellation of his or her loans.

Let me emphasize, my proposal is income-contingent.

The young person is not permitted to earn a market salary.

The minimum wage for one year -- 40 hours a week, 52 weeks a year -- is only $8,800. This is the maximum salary the young person can earn.

I am convinced that many young persons would be willing to perform full-time service if my proposal is adopted.

Young persons who make this commitment and perform this service deserve a break on their student loans.

Cancelling their loans is justified given the hardship the young persons have endured in serving their community.

Simple Equity

Second, my proposal extends the Peace Corps and VISTA model of service into the private sector.

We should provide the same incentives for comparable full-time service in the public and private sectors.

Peace Corps and VISTA volunteers have received deferments on the repayment of their loans since the 1960's.

In 1980 Mr. Chairman you were responsible for extending this same deferment to young persons who performed service in the private sector that is comparable to the service of Peace Corps and VISTA volunteers.

Comparable service in this case is full-time, low-paid service in the private sector with a with a non-profit community service organization, like the Red Cross or the Jesuit Volunteer Corps.

You recognized then that it doesn't make any difference to the Congress if the young person performs full-time, low-paid service with the Peace Corps or VISTA or with a comparable private sector community service organization.

This is a matter of simple equity.

In 1986 the Congress enacted a law providing for partial cancellation of the Perkins loans of Peace Corps and VISTA volunteers, but it did not provide this same benefit for those who perform comparable service in the private sector.

In 1987 I first introduced my proposal to partially cancel the Perkins loans of young persons who perform comparable service.

The purpose of my proposal is to <u>equalize</u> the treatment of Peace Corps and VISTA volunteers <u>and</u> of volunteers performing comparable service with a private sector community service organization.

When I reintroduced my proposal in 1989 and 1991 I provided for partial cancellation of <u>Stafford loans as well as Perkins loans.</u>

The partial cancellation of <u>Perkins and Stafford</u> loans would be available for <u>both Peace Corps and VISTA volunteers and those who perform comparable service</u>.

I am proposing to cover Stafford loans because they are extended to many more young persons than are Perkins loans, so we have a more powerful incentive for community service if we cover both Stafford and Perkins loans.

Last year as part of the National Service legislation my proposals for partial cancellation of <u>Perkins</u> loans was adopted in both the House and Senate. My proposal for partial cancellation of <u>Stafford</u> loans was only adopted in the Senate.

As you know, all of the provisions of the National Service bill amending the Higher Education Act were taken out of the bill in the conference so they could be considered in this reauthorization bill.

<u>**Encourages Community Service**</u>

<u>Third</u>, the purpose of the loan cancellation I am proposing is simply to encourage young persons to devote a year or more of their lives to full-time service in their community.

I am not attempting to change their career plans.

Once these young persons have performed this service, their career plans might change, but that is not the purpose of the proposal.

Student loan debt is a major barrier to full-time community service.

Partial cancellation of a student's loans will tell students not to worry about their loan debt when they consider full-time service.

Cost-Effective

Finally, my proposals are extremely cost-effective.

The Congressional Budget Office has found that my proposal for partial cancellation of Perkins loans would cost less than $500,000 per year.

C.B.O. has found that my proposal for partial cancellation of Stafford loans would cost $2-4 million per year when it's fully implemented.

C.B.O. estimates that approximately 2,000 full-time volunteers would qualify for the partial loan cancellation program I am proposing.

The Peace Corps budget for Fiscal 1991 was about $185 million and this funded about 5,000 volunteers.

The students who would tend to have the largest loan balances are those with graduate degrees, like doctors and lawyers. My partial loan cancellation is an incredibly cheap way

to encourage these professionals to perform full-time service in the community.

CONCLUSION

So, let me conclude by saying that my proposal

-- requires a major sacrifice;

-- it extends the Peace Corps and VISTA model of service into the private sector and equalizes the incentives for comparable full-time service in the public and private sectors;

-- it is not designed to change the career plans of those who serve;

-- and it's incredibly cost-effective.

I would be happy to answer your questions about my proposal.

N·A·S·F·A·A

April 3, 1991

The Honorable Dale Bumpers
229 Senate Dirksen Office Building
Washington, DC 20510-0401

Dear Senator Bumpers:

Thank you for providing us with the information concerning S. 527, which you introduced on March 4. We certainly agree with you that increased reliance upon student loans to help young people pay for postsecondary education has resulted in indebtedness levels that discourage many of these people from selecting lower paying jobs, or working for some non-profit community service programs upon completing their degrees. Your idea of providing loan forgiveness to both Stafford and Perkins borrowers is, therefore, worthy of consideration.

As I understand your bill, a former student loan borrower who becomes a full-time employee of a non-profit tax exempt community service organization would be entitled to 10% cancellation of their Perkins and/or Stafford loan for the first year of such service. The borrower would be entitled to 15%, 20%, and 25% cancellation for subsequent employment in their second, third, and fourth year of employment for a potential maximum loan cancellation of 70%. Further, in order to be eligible to qualify for such cancellation, the employee could not receive compensation which is greater than minimum wage rate, currently $4.25 per hour, or an amount not to exceed 100% of the poverty line for a family of two as defined in Section 673(2) of the Community Services Block Grant Act.

While our Association has proposed that Congress consider reducing and consolidating loan deferment and cancellation provisions under both the Stafford and Perkins student loan programs, we concur that if cancellation is to be available, that the kind of service you have identified is as deserving as some others which are authorized. I should also note that unlike other service cancellation options, your proposal would restrict the amount of compensation that a person could earn and still qualify for cancellation. This income restriction, in my opinion, is overly restrictive, and will greatly limit the number of people who will qualify for the cancellation.

While I realize that most non-profit community service entities have lower rates of compensation than do other profit making firms, I still think your proposed compensation levels are overly restrictive, and will actually discourage young people from pursuing the kinds of work that you are encouraging. Most non-profits pay at least Federal minimum wage rates for beginning employees, and annual increases above that for satisfactory service. Under your proposal, however, such a person might not be eligible for annual increases above the minimum wage rate increase, unless they were willing to give up their loan cancellation benefits in subsequent years. The problem is even further compounded if a non-profit agency hired two recent college graduates and one of them had a high level of student loan indebtedness, and the other only a small amount. Assume both were paid the current federal minimum wage rate of $4.25 per hour for their first year of service, and

The Honorable Dale Bumpers
April 3, 1991
Page Two

each were eligible, therefore, for 10% cancellation. In the second year of their employment their average salary might be increased to $5.25 per hour. Since this would place both of them outside of the applicable compensation level for cancellation, they would then have to choose either to accept less pay or forgo cancellation of their loans. Because of differing levels of indebtedness, the benefits of cancellation also differ. While this already creates some inequities, assume that the person with the higher level of debt also had a non-working spouse and the other person was single. The differences and financial needs of the two workers are now even greater. While there may be no way to achieve total equity because of individual circumstances and choices, I believe we should focus on what factors will most encourage young people to work for community service entities.

Research seems to show, at least encouraging people to enter and serve in teacher shortage areas, that student loan cancellation benefits, per se, are only somewhat effective in altering career choices. As such, if you further limit the benefits of loan cancellation with very restrictive and low compensation wages, then I doubt that your legislation will significantly attract people into community service type jobs. I would therefore either remove altogether the income variables, or alter them to be at least double what is allowed. This would make the bill's provisions more competitive with other cancellation provisions which are currently available to former students.

I hope that these comments will be helpful. If you wish to discuss the bill further, please let me know, and thank you for your continued interest and support of education.

Sincerely,

Dallas Martin

Dallas Martin
President

ADM/rct

National Headquarters
Washington, DC 20006

American Red Cross

Elizabeth Dole
President

April 19, 1991

Dear Senator Bumpers: Dole —

Thank you for your letter addressed to my predecessor, Mr. Richard F. Schubert. Mr. Schubert has left the presidency of the American Red Cross and is currently serving as President and CEO of the newly established Thousand Points of Light Foundation.

I am taking the liberty of answering in his place, since your letter asks the American Red Cross to comment on the National and Community Service Incentive Act of 1991 (S.527). This bill would provide incentives in the form of partial cancellation of Perkins and Stafford college loans for recent college graduates to work for at least a year in low-paid community service jobs. I am very pleased that you have asked the Red Cross to comment on your proposal. Any initiative that promotes the fuller participation of young people in community service is of interest to us.

We share your concern that many young college graduates are prevented from accepting low-salaried community service jobs, including teaching jobs in primary and secondary schools, because of the need to repay their college loans. We also share your objective of making community service more attractive and more affordable for young people starting out on their first job. As was brought out in the debate on the National and Community Service Act of 1990, early exposure to such work helps form important "habits of the heart". Finally, we agree fully that existing non-profit community service agencies are in the best position to organize service opportunities for interested young adults.

Therefore, the American Red Cross supports S.527 as a useful tool for encouraging young people to enter careers in community service. However, it is important to place the concept of community service in a broader context. In addition to encouraging community service employment for recent college graduates, we need also to encourage community service through volunteerism for people of all ages, education levels, and financial resources.

Recently, the American Red Cross completed a major study of volunteerism known as Volunteer 2000. One of the recommendations of the study was to encourage full-time volunteer commitments through the use of subsistence level stipends, much like VISTA, the Peace Corps, and various state and municipal conservation corps. Unfortunately, private non-profit organizations are virtually prevented from operating such programs because present federal law treats such stipends (except in government-run programs) as wages subject to income tax, social security, and minimum wage requirements. The same logic that excludes from taxation the stipends of VISTA, the Peace Corps, and the civilian conservation corps volunteers, should be applied to similar programs developed by non-profit organizations.

Let me give you an example of how the American Red Cross would use stipended volunteers if legislation were enacted to make it feasible. We currently provide a variety of support services to members of the armed forces and their families on military bases in the United States, Europe, Japan, Korea, Okinawa and, more recently, the Persian Gulf. There are, however, many small military installations which we cannot afford to staff. By recruiting and training volunteers, paying their expenses and a subsistence level stipend, we would be able to staff such installations. We have in the past staffed the naval installation on Diego Garcia in the Indian Ocean with two stipended volunteers, a retired couple. If legislation were enacted to relieve subsistence level stipends for non-profit volunteers from tax, social security, and minimum wage considerations, we could expand our effort and extend it to young adults. Other non-profit organizations would be able to develop programs that fit their mission and special concerns.

As indicated above, the American Red Cross supports S.527. However, we would prefer legislation broad enough to encourage volunteer community service efforts. I have asked Maria Smith, a volunteer with considerable knowledge of community service legislation, to contact your office so that we can continue our discussion.

Thank you for your interest in an issue of great interest and concern to all of us at the American Red Cross.

Sincerely,

Elizabeth

Elizabeth Dole

The Honorable Dale Bumpers
United States Senate
Committee on Small Business
Washington, D.C. 20510-6350

NASW

May 6, 1991

Honorable Dale Bumpers
United States Senate
229 Dirksen Senate Office Building
Washington, DC 20510-0401

Dear Senator Bumpers:

Thank you for sharing with us a copy of S.527, the National and Community Service Incentive Act of 1991. As I am sure you are aware, the social work profession prizes community service and would be happy to go on record in support of your initiative.

At the same time, however, we have some more compelling concerns that S.527 does not address. There are particular human services fields currently in the grip of crisis because of a drastic shortage of qualified staff. Child welfare is one such field, where the paucity of staff has led to caseloads as high as 250 children per worker. This kind of untenable responsibility borne by overextended child protection and foster care workers endangers our children and families.

Salaries for family service workers in the Arkansas Department of Human Services, for example, start at only $13,832. Our experience confirms your contention, Senator, that many young people feel they must forego important service careers because of pressure to repay student loans. While child welfare salaries typically are low enough to steer new graduates with student loan debts away from these crucial positions, they are not low enough to be covered by S.527.

We believe that deferment and cancellation of student loans should be judicially used to help move motivated students into specific areas of dire need, like child welfare.

S.527 clearly deserves NASW's support. We hope we can likewise count on your support for the use of loan forgiveness to enhance staffing in child welfare and other critical fields.

Sincerely,

Mark G. Battle, ACSW
Executive Director

MGB:bks

National Association of Social Workers, Inc. • 7981 Eastern Avenue • Silver Spring, Maryland 20910
Telephone (301) 565-0333 Fax (301) 587-1321

THE NATIONAL CONFERENCE OF CHRISTIANS AND JEWS, INC.

71 FIFTH AVENUE • SUITE 1100 • NEW YORK, N Y 10003 • (212) 206-0006 • FAX (212) 255-6177

April 8, 1990

Mr. Dale Bumpers, Chair
United States Senate
Committee on Small Business
Washington, D.C. 20510-6350

Dear Mr. Bumpers:

This is in response to your request for written comments regarding legislation S. 527 which you introduced last month. Please note that my comments are based primarily upon my role as a citizen concerned with issues surrounding education and community service. NCCJ colleagues in our 70 chapters across the country may not necessarily share the views expressed here.

The spirit of S. 527 is commendable -- a provision which would encourage college graduates to work in the community service arena by partially cancelling student loans. There are several issues which immediately come to mind in trying to understand the effects of the legislation:

1. Does the total debt accumulate interest while the person is engaged in community service or is the rate of cancellation based on actual dollars owed on the student loan?

   If the rate of interest on the loan counters a significant proportion of the rate of cancellation, enthusiasm to do community service would diminish accordingly. If so, the legislation would be of little or no value to college graduates who are caught in the dilemma that you are concerned about.

2. How well do we balance the "prestige of service" between Peace Corps/VISTA and community service in the private, non-profit sector?

   Serving in the Peace Corps and VISTA carries a prestige which is associated with honorable and philantropic (self) giving. S. 527 seems to undermine the historical prestige of volunteerism by focusing on community service as a way for graduates to defer and reduce payment of loans.

   Peace Corps and VISTA volunteers go through orientation ard training before "immersing" themselves in countries and/or communities which would benefit from their services. In most cases, volunteers go to their host communities knowing that they have something to give and something to learn. S. 527 does not pro.ide for any preparation of graduates for community service. It assumes that participants are ready, intellectually and pragmatic-

Page 2

ally, to ge a part of organizations which serve communities in myriad ways. The legislation further assumes that non-profit groups are prepared to include college graduates in carrying out their missions. Some organizations may be ready and willing to be part of this endeavor as a way to obtain cheap labor force or personnel. On the other hand, other organizations may have good intentions of providing apprenticeship or internship training but may not know how to go about launching activities that would mutually benefit the graduates and sponsoring groups.

I wonder, therefore, if non-profits should go through parallel orientation and training (as college graduates should go through) to clarify goals which extend beyond student loan obligations.

I would be willing to assist in assessing and/or outlining the orientation and training agendas for the college graduates and non-profit sector. In the long run, American society should benefit from the entire process.

3. Who will determine which nonOprofit organizations qualify for participation?

   It seems that in plotting initiatives such as this, specific entities have cornered the attention of and benefits from the legislation. Many organizations seem left out deliberately and/or are not given the opportunity to express their needs or to showcase their service capabilities.

4. What steps are to be taken to ensure inclusiveness, innovative approaches and effective ways in promoting community service while alleviating the pressure of meeting student loan obligations?

Volunteerism in our country is alive and well. There is sufficient evidence that our citizens, young and old, are willing and able to serve at no or little cost. However, there is a need to cultivate future volunteer professionals and to invite college graduates to consider careers in community service jobs. This legislation has the potential of meeting these multilevel concerns.

In its present state, I am not able to recommend to NCCJ President Gillian M. Sorensen to support legislation S. 527. There are several questions (including those I raised above) which need clarification particularly in defining the role of organizations such as NCCJ.

Thank you for your interest in my comments. Please keep me informed about the progress of this important piece of legislation. If I could be of further assistance, feel free to call or write me again.

Sincerely,

Rose Marie Del Rosario-Ohm
National Coordinator
Youth and Education Programs

cc: G. Sorensen, NCCJ President

THE FORD FOUNDATION
320 EAST 43RD STREET
NEW YORK, NEW YORK 10017

FRANKLIN A. THOMAS
PRESIDENT

16 April 1991

Dear Senator Bumpers:

Thank you for writing us about your introduction of S. 527. I share the view that it is in the nation's interest to make voluntary service a serious option for college graduates. As you point out, as long as so many young graduates must immediately begin repaying their education debts, they cannot afford to serve others. As a result, the enormous potential of that kind of experience - for the individual, community and nation - is lost.

You might know that the Ford Foundation continues to support Youth Service America, which I think it is fair to say is now among the principal organizations in the nation working to promote voluntary service. I am sure Roger Landrum and the leadership of Youth Service America would be eager to assist you in any way possible.

Sincerely,

The Honorable Dale Bumpers
Chairman
Committee on Small Business
United States Senate
Washington, D.C. 20510-6350

YOUTH SERVICE AMERICA

March 22, 1991

The Honorable Dale Bumpers
Committee on Small Business
Washington, DC 20510-6350

Dear Senator Bumpers:

Thank you for your letter of March 18, 1991 which outlines S. 547, the National and Community Service Incentive Act. This is an important piece of legislation that will give young people who are graduating from college the option to serve their communities and nation by working in the independent sector.

I will bring your bill to the attention of Youth Service America's Working Group on Youth Service Policy for further comment.

Thank you for giving young people the opportunity to serve others.

Sincerely,

Frank Slobig
Director
Policy and Programs

1319 F Street NW Suite 900, Washington DC 20004
202/783-8855 • FAX 202/347-2603

THE UNIVERSITY OF MARYLAND

BALTIMORE COUNTY CAMPUS

The Provost

April 17, 1991

Hon. Dale Bumpers
Committee on Small Business
United States Senate
Washington, D.C. 205 10-6350

Dear Dale,

Thank you for your letter of March 18 asking for written comments on S. 527 which you introduced. I am happy to attach memorandum comments from John Martello, the director of our office of Professional Practice, which gives him good reasons why the Bill should be supported, and a couple of specific comments. If there is some way we can help in securing its enactment, please let me know. I would be glad to testify, or perhaps better, to arrange for one of my colleagues with more direct experience to testify before the House Sub-Committee on Post-Secondary Education and describe how our programs could benefit specifically.

Best regards,

Sincerely,

Adam Yarmolinsky

Encl.

THE UNIVERSITY OF MARYLAND

BALTIMORE COUNTY CAMPUS
Office of Professional Practice

1) See Bumpers' ... 13 ...

Cooperative Education
Internships
Graduate Cooperative Education

Community Service and Learning
Scholars
The Choice Program

MEMORANDUM

TO: Adam Yarmolinsky, Provost

FROM: John S. Martello, Director
Office of Professional Practice

DATE: April 1, 1991

RE: Comments on S.527, National and Community Service Incentive Act of 1991

Thank you for providing me with an opportunity to comment on Senator Bumpers' bill.

Your request is especially timely since I have just returned from a visit (3/19 - 3/22) to Boston where Mark and I recruited students for caseworker positions in The Choice Program. The positions for which we recruited are the type S.527 addresses. The students with whom we spoke (from Boston College, Holy Cross, Providence College, and Harvard) have given me a unique perspective from which to express an opinion.

In short, I support the bill. The idea of supporting community service through partial loan forgiveness is a good one. I believe that this is especially true for public colleges and universities in which the tradition of service is not well established; and because public colleges serve a segment of students who are unlikely to have the resources to afford a year of low paid community service.

I do have two specific comments, however: 1) The amount of allowable pay should be increased (beyond the annualized minimum wage total or the poverty level for a family of two); and, 2) We should think about other positive incentives, such as scholarships, stipends, etc. we could provide to students in college in exchange for service, rather than creating incentives (via debt reduction) after college.

UMBC
Baltimore, Maryland 21228 5398
(301) 455 2494 FAX (301) 455 1074
(301) 455 3233 (Voice/TDD)

Regarding materials that would be of interest in support of this bill, I would call your attention to the following:

- A study by Gansnader and Kingston (1984) which documented the positive correlation between undergraduate service and post graduate employment in service careers;

- A study by Hamilton and Fenzel (1988) which showed adolescents developed pro-social attitudes as a result of service;

- Janet Hansen's survey, titled "Student Loans: Are They Overburdening a Generation? (Report to the Joint Economic Committee of the U.S. Congress, 12/86) which cites studies on both sides of the debate as to whether college debt is a disincentive to service careers.

Although I would support this bill, I do not believe it is the ultimate answer. Specifically,

1. The way to instill an ethic of service among college students is to make service part of the educational mainstream (e.g., our efforts to link service to learning).

2. Positive reinforcement (the application of something rewarding) is far more effective than negative reinforcement (removal of an aversive stimulus) or punishment. Thus, creating positive incentives for service (money, credit) will work better than removing aversive consequences (loans, debt) as a lasting strategy for encouraging civic responsibility.

3. Student debt is probably one of a number of variables which influences college students' career choice. Obviously, our career decisions are based on many variables, including expected income after college.

JSM:kms

INDEPENDENT SECTOR

April 11, 1991

Senator Dale Bumpers
United States Senate
Committee on Small Business
Washington, DC 20510-6350

Dear Dale:

Thank you for your March 18 letter regarding S. 527 which provides incentives for young people to participate in voluntary community service upon graduation from college. It is very important legislation and it was unfortunate that it was dropped in conference along with provisions that would have amended the higher education act.

Your loan cancellation proposals would provide an important incentive for young people to become involved in a wide variety of voluntary community services and we support that initiative.

We are grateful for the leadership you have given to this proposal and we support its enactment.

Sincerely,

Brian O'Connell

cc: Adam Yarmolinsky

Check

National Urban League, Inc.

The Equal Opportunity Building
500 East 62nd Street, New York, NY 10021
Telephone (212) 310-9000

April 8, 1991

The Honorable Dale Bumpers
United States Senate
Washington, DC 20510

Dear Senator Bumpers:

On behalf of the National Urban League, I commend you for introducing the "National and Community Service Incentive Act of 1991" (S.527). The concept of promoting post-graduate voluntary community service through partial cancellation of college loans is a positive one.

Middle and upper income students who can afford to make a financial sacrifice and delay their labor market entry for one or more years will find this prop 1 helpful in fulfilling their desire to do munity service while receiving partial loan can ilation as a special bonus.

However, low income students who have had to make substantial financial sacrifices just to get through college cannot afford to delay their entry into the labor market upon graduation. These young adults recognize the necessity of immediately beginning to build financial stability through full-time employment at above poverty wages, not only for loan repayment, but for a solid foundation for their employment and marital futures.

Honorable Dale Bumpers
April 8, 1991
Page 2

For certain African American students, delay of labor market entry at the critical point of transition from college to full-time employment can create an added barrier to simply getting into the job market, and once in, moving up career ladders. Such students hail from a national situation where the absolute and relative economic status of African Americans is characterized by high unemployment, inferior occupational distributions, low wages, low incomes and high poverty rates. Further, such disparities have persisted at roughly the same level for the last two decades.

In the end, S.527 will be welcomed by those individuals who can afford to take advantage of its provisions. However, for low income black and minority students, the delay of job entry at an important crossroad in their life, coupled with "low-paid" community service work does not represent sound planning for their economic future. It is our hope that this legislation can be made more responsive to these needs so that it can be accessible to all graduates. For example, the wage levels would have to be increased to at least 150% of the poverty line for a family of two.

Thank you for inviting the National Urban League to review S.527 and offer comment.

Sincerely,

John E. Jacob
President and
Chief Executive Officer

GEORGETOWN UNIVERSITY

School of Business Administration
Office of the Dean

Georgetown University
New South, Box 3304
Washington, DC 20057

RD2, Box 348D
Sunbury, PA 17801

April 12, 1991

The Honorable Dale L. Bumpers
229 Senate Dirkson Office Building
Washington, DC 20510-0401

Dear Senator Bumpers:

In today's edition of the Georgetown Hoya, our newspaper of record, it was reported that you are sponsoring a bill in Congress that would "reduce individual students' loans up to 70 percent if they worked for up to four years at a low rate of pay for a community service organization in the private sector". I am writing to voice my support for such a proposal.

As I am sure you know, private college costs have skyrocketed over the past decade. Even with substantial financial aid, I will have at least fifteen thousand dollars ($15,000) in loans to repay at the end of my undergraduate years alone. Obviously, with this amount of debt, taking a low or minimum wage job would hurt my financial stability in the short-run.

I must assure you that your proposal makes me reconsider the possibility of working at something I truly enjoy. I already volunteer my time freely in many different campus activities, including the Knights of Columbus, the Georgetown College Democrats Club, and the Georgetown Admissions Ambassadors Program, which serves to help inform prospective Georgetown students. I also teach Sunday school at Holy Trinity Parish and occasionally volunteer at the S.O.M.E. (So Others Might Eat) shelter, both in the Northwest. While I plan to continue such activities after graduation, I feel that the experience of a full-time volunteer position would be inestimable.

I have but one suggestion that the bill be amended to include public volunteer activities, too. It seems to me that limiting the extent of the bill to only private sector activities limits the possible benefits of the bill as well

I would have liked to have sent a copy of this letter to both the Senators from Pennsylvania, however, because of Sen. Heinz unfortunate death, I will only be sending a duplicate to Sen. Arlen Specter. Please keep me informed on the progress of this legislation. Feel free to contact me if you feel that I could be of any help in gaining student support of this proposal.

Sincerely,

John R Gotaskie Jr.

John Gotaskie, Jr.

cc: The Honorable Arlen Specter

LAW OFFICES

HELLER, ROSENBLATT & SCHEMAN

SUITE 230

1200 NEW HAMPSHIRE AVENUE, N.W.

WASHINGTON, D.C. 20036-6802

(202) 466-4700

[illegible]

[illegible]

March 21, 1991

The Honorable Dale Bumpers
United States Senator
Committee on Small Business
Washington, D. C. 20510-6350

Dear Senator Bumpers:

Thank you for your letter of March 18 regarding your bill, S. 527, on community service. You have requested my comments and they are as follows:

1. My colleagues at CDM and I have long felt that too little is asked of our young people and that, in the absence of a system of universal military service, some form of community service would be highly desirable. We supported Congressman McCurdy's bill in the past.

2. I think the basic idea of rewarding students for their community service in the manner proposed is sound. I have not computed the combined value of the minimum wage base and partial loan forgiveness as against other opportunities which might be available to college graduates, but agree with the bill's clear assumption that the young people to whom this appeal is directed are not likely to be motivated primarily by a desire for gain, so long as they are enabled to meet their obligations.

3. I wonder whether you have, however, considered the possible impact of this program upon potential community service volunteers from older age groups. To the extent that that is important, the bill clearly discriminates in favor of younger people with student loan obligations. Older potential volunteers are likely to have greater resources, but also far greater family and other obligations.

With best wishes,

Sincerely,

Peter R. Rosenblatt

PRR/vw

COALITION FOR NATIONAL SERVICE

5140 SHERIER PLACE N W
WASHINGTON, D.C. 20016
(202) 244 5828

March 20, 1991

Hon. Dale Bumpers, Chairman
Committee on Small Business
United States Senate
Washington, DC 20510-6350

Dear Senator Bumpers:

Many thanks for your letter and enclosure of March 18. We have been corresponding about your proposal for a National and Community Service Incentive for several years and I am optimistic about 1991 being the year it finally passes.

Your proposal is a natural complement to the National and Community Service Act of 1990 and deserves to be enacted.

By coincidence, I just had a visit from a speechwriter for Peace Corps Director Paul Coverdell, who will be speaking to student volunteers at Emory University this weekend. I gave him a copy of your bill and recommended he say something about it as it will be germane to his audience.

Sincerely,

Donald J. Eberly

150 East 52nd Street, New York, New York 10022
(212) 223-4040

The Charles A. Dana Foundation Incorporated

April 18, 1991

Senator Dale Bumpers
United States Senate
Washington, D.C. 20510-6350

Dear Senator Bumpers:

Thank you for your March 18 letter requesting support for your proposed legislation, S. 527. I have reviewed your proposal and believe that it contains many worthy elements.

I have long been a proponent of national service, and I believe that your proposal that full-time, low-paid community service be recompensed by partial cancellation of student loan debts (to the same extent as is now available in the Peace Corps and VISTA programs) appears to provide a useful incentive for such service.

I applaud your efforts to address this national concern and wish you good luck in your attempts to encourage recent college graduates to perform voluntary community service.

Sincerely yours,

Robert N. Kreidler
President

RNK:am

cc: Congressman William D. Ford
Senator Claiborne Pell

INTERNATIONAL LIAISON OF
LAY VOLUNTEERS IN MISSION
U.S. CATHOLIC NETWORK OF LAY MISSION PROGRAMS

MOST REV. JOSEPH A. FRANCIS, S.V.D., D.D.
EPISCOPAL ADVISOR

JOHN R. GEIGER
BOARD CHAIRPERSON

SR. ELLEN CAVANAUGH
EXECUTIVE DIRECTOR

April 14, 1991

Senator Dale Bumpers
UNITED STATES SENATE
Committee on Small Business
Washington D.C. 20510-6350

Dear Senator Bumper:

First of all, I apologize for my lateness in responding to your letter of March 18, 1991, concerning your newest legislation addressing loan deferment and partial cancellation. We are deeply interested in this bill, S.127, for we see herein the actual means for allowing our young people to consider a time of service.

Twice a month we issue a listing of names of persons interested in service. We attain these names through visits to college campuses, addressing youth groups and, in general, sharing our message with all whom we meet.

Senator, if your bill becomes the law we can promise our figures, already on the increase, will at least double. Our young people want to give service but in most instances, because of loans, this service is not possible. PEACE CORPS and VISTA have seen a rise in their serving population. Our private organizations can experience the same growth.

We see in your legislation a means of motivating a next generation. For the good of our nation we must put your challenge before our youth.

We have asked to testify in defense of the legislation and we will continue to use every opportunity to support the legislation.

4121 HAREWOOD ROAD N.E., WASHINGTON, D.C. 20017 (202) 529-1100 1-800-543-5046 FAX (202) 526-1094

Senator Bumpers Page 2.

Our people have been supported considerably by Chuck Ludlam who has been responsive to every inquiry. Chuck, through advice, has sent many a person to a successful "giving time of service".

It is our prayer that with the successful passage of S.527 a nation will experience a continued escalation of giving Americans. Our reward will be great as our future holds Americans who know their birthrights are complete when one reaches out in service to another.

Thank you for all your efforts!

Sincerely yours,

Sister Ellen Cavanaugh, Executive Director

FACT SHEET

PURPOSE

International Liaison of Lay Volunteers in Mission (ILLVIM) is a non-profit network of lay mission programs supported by the U.S. Catholic bishops. Our specific purpose is to coordinate and facilitate the efforts of over 150 lay volunteer programs based in the United States with placement in the U.S. and other countries. This is accomplished by communicating to the laity the urgency of their role in the Mission of the Church. ILLVIM also assists dioceses and religious communities in satisfying their need for lay expertise and dedicated collaboration in mission areas all over the world.

HISTORY

In 1963, the membership association was founded in the Archdiocese of Newark by Father George Mader when the need was identified for a network of volunteer programs. The success of the program is reflected in the number of inquiring individuals. Recent interest in volunteering has resulted in the placement of approximately 4,450 volunteers in 1990, as compared with 1,050 in 1985-86, in member organizations.

OFFICE

The National Office, located in Washington, DC has five staff members. The Executive Director is the only salaried employee. She brings many years of expertise to the office - administration, mission, and networking within the Church. The remaining staff are full time lay volunteers from various backgrounds willing to do service for the Church.

The Board of Directors consists of fifteen-member, lay volunteer program directors who are elected to two consecutive two-year terms.

The Consultative Committee, who assists the Board of Directors, are four professionals with backgrounds in finance, government, and business.

The Episcopal Advisor is Most Reverend Joseph A. Francis, Auxiliary Bishop of Newark, New Jersey.

SERVICES

Services of the ILLVIM office are currently supported through ILLVIM member dues, grants and donations. These services/activities have increased fivefold since 1986. Foremost services consist of:

THE RESPONSE - catalog listing mission opportunities available
HOW CAN I HELP? - Bi-weekly listing of potential volunteers
Conferences, workshops, other informative tools for volunteer programs
Networking and recruitment of volunteers with 1-800 telephone number

INTERNATIONAL LIAISON OF LAY VOLUNTEERS IN MISSION
4121 HAREWOOD RD., NE WASHINGTON, DC 20017 202-529-1100 1-800-543-5046

EVANGELICAL LUTHERAN
CHURCH IN AMERICA

March 26, 1991

Mr. Dale Bumpers
Committee on Small Business
United States Senate
Washington, DC 20510

Dear Mr. Bumpers:

Your letter of March 18, directed to Mis. Susan Brook, Evangelical Lutheran Church in America, 8765 West Higgins Road, Chicago, Illinois 60631, has been forwarded to me. I have replaced Mis. Brook as the Director for Lutheran World Mission Volunteers.

Please substitute my name, Dr. Jack F. Reents, for Miss Susan Brook on your mailing list. Thank you very much for your cooperation in this matter.

I read with interest your proposed bill for making it easier for people who go into volunteer service to postpone the repayment of their student loans. With my past experience with volunteers, this is a key issue for them in being able to take a volunteer or stipended position.

Sincerely yours,

Dr. Jack F. Reents
Director
Lutheran World Mission Volunteers

JFR/kr

APR. 9 1991

/13C

Idea of national service means repaying a debt

National service recently got an endorsement from some important people.

Gen. Norman Schwarzkopf, our leader in the Persian Gulf, told Barbara Walters on national TV that he supported the idea. Then last week, William F. Buckley, the conservative writer and television commentator, praised it glowingly in Searcy at Harding University's final lecture in the 1990-91 American Studies series.

Robert McCord

These men represent groups that usually find fault with compulsory national service.

The military's objection is that today's weapons are too complicated to be operated by people dragged in off the streets. Besides, the one year of service that is usually talked about is too short a time to teach someone how to be a soldier. Conservatives usually reject national service as a restriction of freedom (conscription) and an enlargement of government.

But Schwarzkopf is so popular at the moment and Buckley such a recognized conservative intellectual that their endorsements could have an effect. But probably not much until there is a Democrat in the White House.

It's true that the first national service pilot programs were passed last October with the help of Republican President George Bush. He talks a good game of voluntarism and has set up a Office of National Service in the White House and caused his friends to start the Points of Light Foundation in Washington to encourage Americans to become volunteers and help in all kinds of worthy causes.

But the national service of Bush and most Republicans is highly gentrified. They think of it being performed only by those who could work at a nursing home for free instead of getting a summer job, or whose families would sustain them for a year between high school and college while they taught illiterates.

Republicans almost beat the pilot programs in Congress because the Democrats insisted that the volunteers at least had to be given living expenses. Finally they were passed after Democrats insisted that most Americans could never afford to sign up without money to live on.

Eight pilot programs will be created, and it would be great if Arkansas were selected for one of them. Even though President Bush has not even named the 21 commissioners who will run these programs, the governor's office and our Congressional delegation ought to be getting ready to apply. Sen. Dale Bumpers, D-Ark., supports national service and is expected to try to get Arkansas involved.

Some leaders among conservatives and the military now support it.

What kind of national service would be best for the country? Well, pretty much what Buckley explained to a couple of thousand people in Searcy.

He called it "paying the debt we owe to our patrimony." How do we repay the founding fathers for the Bill of Rights, the debt we owe our parents and teachers?

His answer is that at age 18 young men and women would be required to spend a year doing non-professional work with the aged, in education, the environment, law and order, etc. Buckley has a good suggestion for getting it started: 40 of the leading colleges could require all freshmen in the class of 1993 to have completed one year of public service.

The Democratic Leadership Council's approach, which is the best one, in my opinion, also would include the military as an avenue of service and provide a stipend for all volunteers that could be used for college, down-payment on a home or starting a business.

Buckley didn't mention the military or a post-service reward. What he stressed was the value of the young helping the old. "For the aged it would mean continuing contact with young spirited people in their most effusive years. It would remind young people at their most impressionable age of the nature of genuine humanitarian service, which is the disinterested personal act of kindness administered by one individual directly to another individual.

"The experience would touch the young with the reality of old age, the capacity to give pleasure to others without the stimulus of drugs or sex ... and reinforce the best instincts of American youth, instincts that go unstimulated at our peril."

Thus, young people would learn how to acknowledge a "a debt they cannot repay" to a nation that must be preserved and nourished as it has nourished them, Buckley said.

"We need to guard against any possibility that forgetful generations will fail to serve it."

Senior Editor Robert McCord's columns appear on Tuesday, Thursday and Sunday.

NISBCO

National Interreligious Service Board for Conscientious Objectors

28 March 1991

Senator Dale Bumpers
Attn: Chuck Ludlam
Committee on Small Business
Washington, DC 20510-6350

Dear Senator Bumpers:

I was gratified to see you introduce S. 527. As you know, NISBCO supported the similar legislation you proposed last year. We will do what we can to help secure passage for S. 527.

Perhaps the most compelling aspect of your proposal is that it builds on existing community service structures. It will give needed support to small community service groups, and to service-minded students, by simply allowing community service to be an affordable option.

This legislation does away with the myth that the only way we can remedy our social ills, and give substance to our benevolent impulses, is through an extensive, intrusive, and (if some national service proponents have their way) coercive government program. Instead of contributing to a large, expensive, and inefficient government bureaucracy, this bill supports the already ongoing efforts of existing service programs. Instead of undermining private initiative service programs, it enhances them.

I have two questions: what if a person sandwiches two terms of service around a period of non-service? For example, a person completes a two-year service program. After working elsewhere for a year, he or she returns for another two-year service program. Would the loan forgiveness program begin again at the first-year forgiveness rate (10%), or would it resume at the third-year forgiveness rate (20%)?

Secondly, why does this bill not pertain to loans already made? If I understand correctly, a loan made this year by a college freshman would not be eligible for forgiveness under this Act. We would like to see the bill support students with educational loans who would like to serve, regardless of whether they graduated in 1989 or graduate in 1994.

Sincerely,

Arlyn Miller

Arlyn Miller
Legislative Liaison

Suite 750, 1601 Connecticut Ave., NW, Washington, DC 20009-1035 (202) 483-4510

FCNL
FRIENDS COMMITTEE ON NATIONAL LEGISLATION
245 Second St., NE, Washington, DC 20002-5795
(202)547-6000 Office
(202)547-4343 Update Message
(202)547-6019 FAX

March 21, 1991

Senator Dale Bumpers
U.S. Senate
Washington D.C. 20510

Dear Senator Bumpers:

We are very interested in your community service bill, S. 527. We agree that the repayment of student loans is a significant barrier to community service -- especially (ironically) for low-income students who might want to give of their time and skills to help improve their communities a bit.

The wage rate that establishes eligibility for the program, however, seems too low to be of much help -- especially (again) to the lower-income students who have no family resources to support them during their year of service. Depending on the expense of the area in which they work, the minimum wage rate may not provide adequate support to keep body and soul together. For example, we provide approximately $1000 a month for our interns here in D.C., the ones who are able to get by on that live very frugally in group homes. Others have told us that they just wouldn't be able to afford to live in D.C. on our stipend.

Two possibilities occur:

1. I recall (from my own days in VISTA) that the ACTION agency provides a housing and food allowance in addition to a stipend. Could agencies provide the same for their volunteers, leaving the volunteers' cash income below the guidelines?

2. Perhaps the minimum wage rate could remain as the eligibility standard for *partial cancellation* of the loan, and a somewhat higher rate could qualify an individual for an additional period of *deferment*.

The concept of the legislation is positive, and we hope to be able to support it. Our concern is that, by setting the eligibility standard too *low*, the bill might actually benefit volunteers who are a little better off financially, and be of little assistance to those who actually have to "make it" on the stipend they receive during their volunteer year.

I'll call or stop by to speak with Chuck Ludlum, as you suggest, in the next week or so.

Sincerely,

Ruth Flower

Ruth Flower

Bumpers Community Service Incentives
Principal Advantages

Encourages Full-Time, Long-Term Community Service

Extends Peace Corps & Vista Model of Service into Private Sector

Reduces Major Barrier to Community Service – Student Loan Debt

Promotes Service that is Entirely Voluntary

Requires Financial Sacrifice to Qualify for Incentive

Based on Financial Need of Volunteer

Very Low Cost to Government

No New Government Bureaucracy required to Administer

Bumpers Community Service Incentives

Qualifying Service

- Service as a Peace Corps or Vista volunteer, or
  - Comparable service, meaning –

Full– Time service; For at least a year;
With tax–exempt community service organization;
And paid no more than the federal minimum wage.

Incentive

- Receive partal Cancellation of Perkins/Stafford loans

10% Cancelled (1st year of service)
15% Cancelled (2nd year of service)
20% Cancelled (3rd year of service)
25% Cancelled (4th year of service)
Total: 70% Cancelled with 4 years of service

Existing Community Service Incentives

Type of Service	Deferment on Repayment as Serve	Partial Cancel Perkins	Partial Cancel Stafford
Peace Corps/Vista Volunteers	YES, since 1960's	YES, since 1986	NO
Comparable Service with tax-exempt Community service organizations	YES, since 1980	NO	NO

Bumpers Community Service Incentives

Type of Service	Deferment on Repayment as Serve	Partial Cancel Perkins	Partial Cancel Stafford
Peace Corps/Vista Voluteers			YES
Comparable Service with tax-exempt Community service organizations		YES	YES

S.527

By Mr. BUMPERS (for himself, Mr. CRANSTON, and Mr. AKAKA):

S. 527. A bill to provide for the partial cancellation or repayment of Perkins and Stafford loans for student borrowers who perform a year or more of full-time, low-paid service as Peace Corps and VISTA volunteers, and comparable full-time, low-paid service with a tax-exempt community service organization in the private sector; to the Committee on Labor and Human Resources.

NATIONAL AND COMMUNITY SERVICE INCENTIVE ACT

Mr. BUMPERS. Mr. President, today I am introducing the National and Community Service Incentive Act of 1991. This legislation would amend the Higher Education Act, which is due for reauthorization this year. The purpose of the bill is to provide for partial cancellation of student loans under the National Direct Student Loan and Guaranteed Student Loan Programs for people who serve full-time in nonprofit, tax-exempt community organizations. The bill would also provide for the same partial cancellation of Guaranteed Student Loans for Peace Corps and VISTA volunteers, who are already entitled to partial cancellation of national direct student loans under current law.

Last year my proposal was adopted by the Senate as part of the national and community service legislation. Much of my proposal was also adopted by the House in its version of the national service legislation. Unfortunately, my proposal was dropped in conference along with all other provisions that would have amended the Higher Education Act because the conferees believed that it made sense to defer consideration of all amendments to the Higher Education Act so that they could be considered as part of the reauthorization legislation.

I look forward to working with Senator KENNEDY, chairman of the Senate Labor and Human Resources Committee, and Senator PELL, chairman of the Subcommittee on Education, to secure enactment of this legislation. I very much appreciate their strong support last year during consideration of the national and community service legislation and look forward to their continued support in this Congress.

My loan cancellation proposals would enable young people to provide community service by reducing the pressure they feel to begin repayment of student loans. This legislation would reduce this debt burden for students when they serve in full-time, low-paid jobs with nonprofit community service organizations. A student borrower would qualify for cancellation of 10 percent of national direct student loans or guaranteed student loans after 1 year of service, an additional 15 percent after the second year, 20 percent after the third year, and 25 percent after the fourth year. The maximum cancellation is 70 percent of the loans.

This bill specifies that, in order to qualify for loan cancellation, a student borrower working in a nonprofit community organization could earn a salary equal to the annualized minimum wage or 100 percent of the poverty line for a family of two. The legislation that introduced in the 101st Congress did not provide this alternative. I added it because the maximum compensation standard for participants in the American Conservation and Youth Corps Program and the Community Service Demonstration Program is tied to the poverty line. Providing compensation standards in the alternative avoids asymmetry between the National Service Act Programs and the partial loan cancellation provisions.

Many college graduates are unable to work in community service jobs because of the debts they have accumulated in order to attend college. In fact, in several surveys loan debts were the reason most frequently cited by students for not performing a period of community service. The need to secure a high paying job to repay student loans is a function of reality, not selfishness. I applaud this sense of responsibility for repayment of debts. I wish everyone felt that responsibility.

But the problem is that once a student takes that first paying job, he or she has passed by a major opportunity to provide service to the community. The first years after college are the perfect time for young people to provide service. They are less likely to be burdened with other responsibilities, such as children, mortgages, and career ladders.

My proposal is a cost-effective way to promote full-time voluntary community service. It encourages community service in the private sector while providing opportunities for young people to offer their services. Substantial financial sacrifices must be made by the participants, but the whole program carries a very low price to the Government.

This is an American model of voluntary service. It taps the diversity and energy of America's unique and independent nonprofit sector.

I ask unanimous consent that the bill be printed in the RECORD.

There being no objection, the bill was ordered to be printed in the RECORD, as follows:

S. 527

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "National and Community Service Incentive Act of 1991".

SEC. 2. FINDINGS.

The Congress finds that—

(1) the dramatic increase in student loan indebtedness is one of the principal reasons why graduates of the Nation's colleges and universities do not believe they can afford to perform a year or more of full-time, low-paid community service upon graduation;

(2) providing for partial cancellation and repayment of such students' Perkins and Stafford loans will enable and encourage such students to perform a year or more of full-time, low-paid community service upon graduation;

(3) Peace Corps and VISTA volunteers already qualify for partial cancellation of Perkins loans and it is only fair that young persons who perform comparable full-time, low-paid service with tax-exempt community service organizations in the private sector receive the same incentive; and

(4) partial cancellation of Stafford loans, which form the largest share of Federal student loans, for Peace Corps and VISTA volunteers and for young persons who perform comparable service with a tax-exempt community service organization, will provide young persons a powerful additional incentive to perform a year or more of full-time, low-paid community service.

SEC. 3. PARTIAL CANCELLATION OF PERKINS LOANS.

(a) IN GENERAL.—Section 465(a)(2) of the Higher Education Act of 1965 (in this Act referred to as the "Act") (20 U.S.C. 1087ee(a)(2)) is amended—

(1) by striking out "or" at the end of subparagraph (D);

(2) by striking out the period at the end of subparagraph (E) and inserting a semicolon and "or"; and

(3) by adding at the end thereof the following new subparagraph:

"(F) as a full-time employee performing service comparable to the service described in subparagraph (E) for an organization which is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986 if the borrower does not receive compensation which exceeds the greater of—

"(i) the minimum wage rate described in section 6 of the Fair Labor Standards Act of 1938; or

"(ii) an amount equal to 100 percent of the poverty line for a family of two (as defined in section 673(2) of the Community Services Block Grant Act).".

(b) PERCENTAGE OF PARTIAL CANCELLATION.—Section 465(a)(3)(A) of the Act (20 U.S.C. 1087ee(a)(3)(A)) is amended—

(1) by striking "or" at the end of clause (iii);

(2) by amending clause (iv) to read as follows:

"(iv) in the case of service described in subparagraph (F) of paragraph (2) at the rate of 10 percent for the first year of such service, 15 percent for the second year of such service, 20 percent for the third year of

such service, and 25 percent for the fourth year of such service; or";

(3) by adding at the end thereof the following new clause:

"(v) in the case of service described in subparagraph (F) of paragraph (2), at the rate of 10 percent for the first year of such service, 15 percent for the second year of such service, 20 percent for the third year of such service, and 25 percent for the fourth year of such service.".

(c) TECHNICAL AMENDMENT.—Section 465(a)(2)(A)(v) of the Act (20 U.S.C. 1087ee(a)(2)(A)(v)) is amended by striking "Internal Revenue Code of 1954" and inserting "Internal Revenue Code of 1986".

SEC. 4. PARTIAL REPAYMENT OF STAFFORD LOANS BY THE SECRETARY.

(a) IN GENERAL.—(1) Section 427(a)(2)(B) of the Act (20 U.S.C. 1077(a)(2)(B)) is amended by inserting after "that" a comma and the following "subject to the provisions of subparagraph (M),".

(2) Section 427(a)(2) of the Act (20 U.S.C. 1077(a)(2)) is amended by—

(A) striking out "and" at the end of subparagraph (O);

(B) redesignating subparagraph (M) as subparagraph (N), and

(C) inserting after subparagraph (O) the following new subparagraph.

"(M) provides (subject to the provisions of section 428(k)) in the case of any student borrower who, prior to the beginning of the repayment period, agrees in writing to volunteer for service under the Peace Corps Act or under the Domestic Volunteer Service Act of 1973, or to perform comparable service as a full-time employee of an organization which is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986 if the borrower does not receive compensation which exceeds the greater of—

"(i) the minimum wage rate described in section 6 of the Fair Labor Standards Act of 1938; or

"(ii) an amount equal to 100 percent of the poverty line for a family of two (as defined in section 673(2) of the Community Services Block Grant Act),

for the payment by the United States of the percent of the amount of loans specified in section 428(k)(3); and".

(b) INSURANCE PROGRAM.—(1) Section 428(b)(1)(D) of the Act (20 U.S.C. 1078(b)(1)(D)) is amended by inserting after "paragraph" the following: "and subject to subparagraph (V)".

(2) Section 428(b)(1) of the Act (20 U.S.C. 1078(b)(1)) is amended by—

(A) striking "and" at the end of subparagraph (U);

(B) striking the period at the end of subparagraph (V) and inserting a semicolon and "and"; and

(C) adding at the end thereof the following new subparagraph.

"(W) provides (subject to the provisions of section 428(k)) in the case of any student borrower who, prior to the beginning of the repayment period, agrees in writing to serve as a volunteer for service under the Peace Corps Act or under the Domestic Volunteer Service Act of 1973, or to perform comparable service as a full-time employee of an organization which is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986 if the borrower does not receive compensation which exceeds the greater of—

"(i) the minimum wage rate described in section 6 of the Fair Labor Standards Act of 1938, or

"(ii) an amount equal to 100 percent of the poverty line for a family of two (as defined in section 673(2) of the Community Services Block Grant Act),

for the payment by the United States of the percent of the amount of loans specified in section 428(k)(3).".

(c) PARTIAL REPAYMENT BY THE SECRETARY.—Section 428 of the Act (20 U.S.C. 1078) is amended by adding at the end thereof the following new subsection:

"(k) PARTIAL REPAYMENT AUTHORITY.—(1) The Secretary shall enter into an agreement with any student borrower described in section 427(a)(2)(M) or 428(b)(1)(W) under which the borrower agrees to serve as a volunteer under the Peace Corps Act or under the Domestic Volunteer Service Act of 1973, or to perform comparable service as an employee of an organization which is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986 if the borrower does not receive compensation which exceeds the greater of—

"(A) the minimum wage rate described in section 6 of the Fair Labor Standards Act of 1938, or

"(B) an amount equal to 100 percent of the poverty line for a family of two (as defined in section 673(2) of the Community Services Block Grant Act).

"(2) The agreement described in paragraph (1) shall contain provisions designed to assure that—

"(A) the Secretary will assume the obligation of paying the percent of any loan made, insured, or guaranteed under this part pursuant to the partial repayment schedule described in paragraph (5), and

"(B) the student borrower who fails to volunteer for service in accordance with the agreement described in paragraph (1) will assume the obligation of paying the amount of any such loan attributable to the period for which the student borrower failed to comply with such agreement.

"(3) The Secretary shall in each fiscal year pay to the holder of each loan for which the Secretary assumes responsibility under this subsection the amount specified in paragraph (5).

"(4) The Secretary shall waive or suspend any obligation of service or payment of any, or any part of, the loan to which the United States is entitled under this subsection whenever the Secretary determines that compliance by an individual with the agreement described in paragraph (1) is impossible or would involve extreme hardship to the individual.

"(5)(A) The percent of a loan which shall be paid by the United States under paragraph (3)(A) of this subsection is 10 percent for the first year of service described in paragraph (1), 15 percent for the second year of such service, 20 percent for the third year of such service, and 25 percent for the fourth year of such service.

"(B) If a portion of the loan is paid by the Secretary under this subsection for any year, the entire amount of interest on such loan which accrues for such year shall be paid by the Secretary.

"(C) Nothing in this subsection shall be construed to authorize refunding of any repayment on the loan.".

SEC. 5. MAXIMUM COMPENSATION REQUIREMENT FOR DEFERMENT OF STAFFORD AND PERKINS LOANS.

(a) STAFFORD LOANS.—(1) Section 427(a)(2)(C)(v) of the Act (20 U.S.C. 1077(a)(2)(C)(v)) is further amended—

(A) by striking "volunteer for" and inserting "employee of", and

(B) inserting before the semicolon at the end thereof the following "if the borrower does not receive compensation which exceeds the greater of—

(i) the minimum wage rate described in section 6 of the Fair Labor Standards Act of 1938, or

(ii) an amount equal to 100 percent of the poverty line for a family of two (as defined in section 673(2) of the Community Services Block Grant Act)".

(2) Section 428(b)(1)(M)(iv) of the Act (20 U.S.C. 1078(b)(1)(M)(iv)) is amended—

(A) by striking "volunteer for" and inserting "employee of"; and

(B) inserting before the semicolon at the end thereof the following: "if the borrower does not receive compensation which exceeds the greater of—

"(i) the minimum wage rate described in section 6 of the Fair Labor Standards Act of 1938, or

"(ii) an amount equal to 100 percent of the poverty line for a family of two (as defined in section 673(2) of the Community Services Block Grant Act).".

(b) PERKINS LOANS.—Section 464(c)(2)(A)(v) of the Act (20 U.S.C. 1087dd(c)(2)(A)(v)) is amended—

(1) by striking "volunteer for" and inserting "employee of"; and

(2) inserting before the semicolon at the end thereof the following: "if the borrower does not receive compensation which exceeds the greater of—

"(A) the minimum wage rate described in section 6 of the Fair Labor Standards Act of 1938, or

"(B) an amount equal to 100 percent of the poverty line for a family of two (as defined in section 673(2) of the Community Services Block Grant Act).".

SEC. 6. EFFECTIVE DATE.

The amendments made by this Act shall apply only to loans made to cover the costs of instruction for periods of enrollment beginning on or after thirty days after the date of enactment of this Act.

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